

R E P O R T
ON THE
VISIT TO EASTERN EUROPE
OF THE
SENATE DELEGATION LED BY
SENATOR JOHN HEINZ

POLITICAL AND ECONOMIC DEVELOPMENTS IN CENTRAL AND
EASTERN EUROPE AND THEIR IMPLICATIONS FOR UNITED
STATES FOREIGN ECONOMIC POLICY



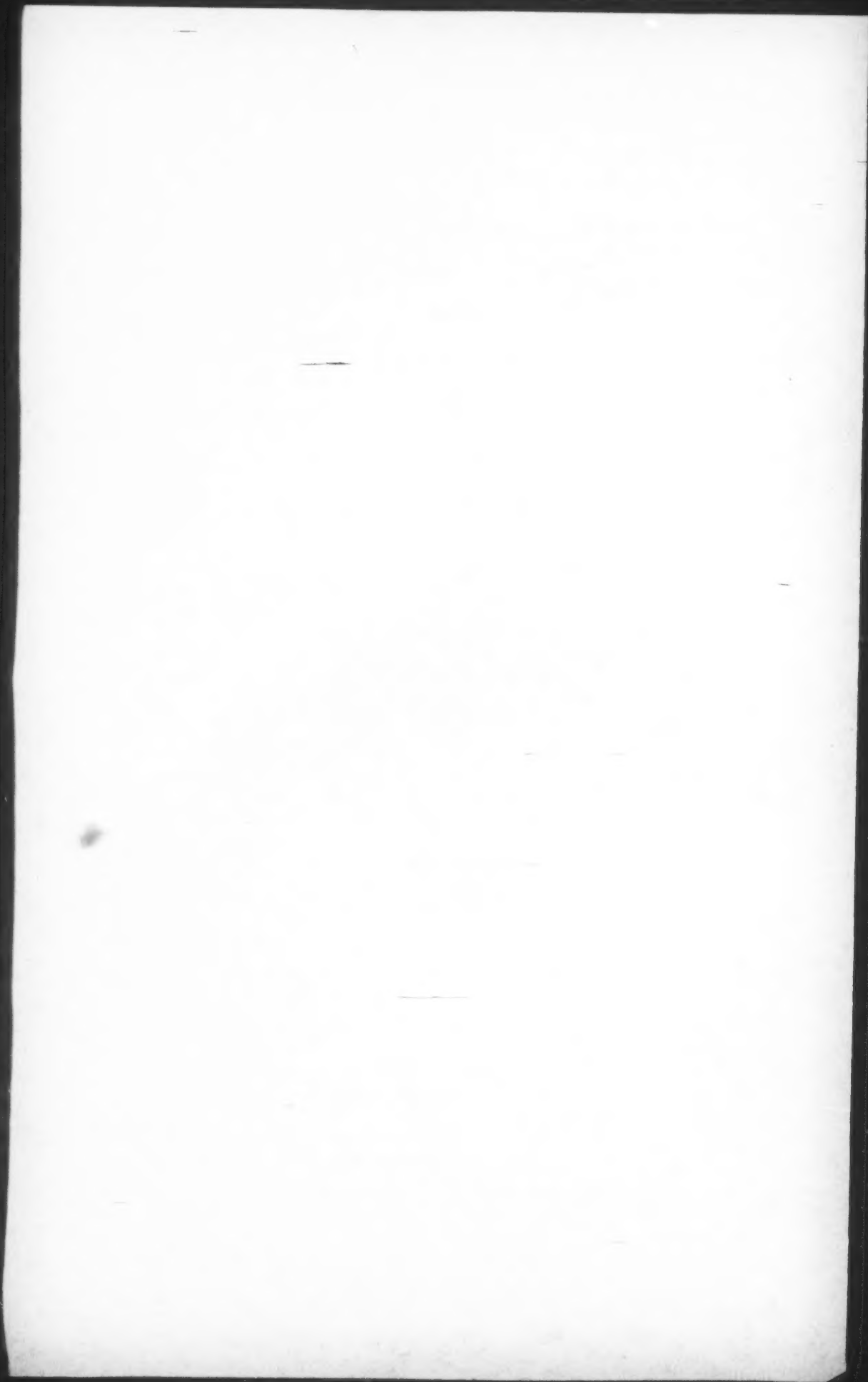
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Mr. HEINZ, from the Committee on Banking, Housing, and Urban
Affairs, submitted the following

REPORT

to the

UNITED STATES SENATE

SUMMARY

OVERVIEW OF DELEGATION VISIT

Between April 6 and 16, 1990, a Senate delegation consisting of Senators John Heinz, Jake Garn, Christopher Bond, and John Chafee visited four countries in Eastern Europe: the German Democratic Republic, Poland, Hungary, and Czechoslovakia.

The delegation traveled to seven cities in all: West and East Berlin, Bitterfeld in the German Democratic Republic; Budapest, Hungary; Krakow and Warsaw in Poland; and Prague, Czechoslovakia. In each city, the delegation met both with government officials and members of various political parties, including the East German Christian Democrats, Hungary's Democratic Forum and Alliance for Free Democrats, and Civic Forum in Czechoslovakia.

The delegation departed Andrews Air Force Base on the morning of Friday, April 6, and arrived in West Berlin that evening. On Saturday, April 7, the delegation began its review of environmental conditions in Eastern Europe with a trip to Bitterfeld, the capital of East Germany's chemical industry about 90 minutes south of Berlin. According to Greenpeace, Bitterfeld "is the dirtiest place in the most polluted country in the world" (Washington Post, April 16, 1990).

On Monday morning, April 9, the delegation was briefed by the U.S. embassy in East Berlin on a full-range of political, economic,

and commercial issues, including the implications of German reunification for U.S. foreign policy. After the briefing, the delegation met with Eberhard Geissler, Acting President of the GDR State Bank. Mr. Geissler discussed economic and monetary union with the FRG and the establishment of a commercial banking system in the GDR. Later in the morning, the delegation met with Christian Democratic Union East leaders, including Hans-Joachim Boerner, who is responsible for policy on small and medium-size companies and Eberhard Wiedermann, who handles issues related to agriculture and the environment. Joining them was Mr. Elmar Pieroth from the CDU-West, who at the time was widely touted—incorrectly, as it turned out—to become the Economics Minister in the government of GDR Premier Lothar DeMaziere. At noon, Charge' J.D. Bindenagel hosted a luncheon in honor of the delegation, which included several guests from the GDR high technology community as well as embassy personnel.

At 2:00 p.m., the delegation departed West Berlin for Budapest. Upon arrival at Ferihegy Airport, the delegation was taken directly to a meeting with the President of the victorious Hungarian Democratic Forum (HDF) and the soon-to-be designated next prime minister of Hungary, Jozsef Antall, at the HDF's headquarters. The night before, the HDF had won Hungary's first free legislative elections in over 40 years, winning nearly 43 percent of the 386 contested seats in the National Assembly. The meeting lasted for nearly an hour and a half, during which time the two sides discussed substantive issues related to the elections the day before, the U.S. presence in Europe, foreign debt, and technology transfer and export control restrictions. That evening, the Charge', Don Kursch, hosted a reception for the delegation.

On Tuesday, April 10, the delegation participated in a roundtable discussion devoted entirely to technology transfer and export control issues at the Ministry of Industry. The Hungarian side was led by Laszlo Pal, the State Secretary for the Ministry of Industry. The Hungarian side also included officials from the Ministries of Trade, Foreign Affairs, Customs, and Justice. The roundtable discussion was initiated with the presentation of a sophisticated video outlining the backward state of Hungary's technology, particularly in the telecommunications sector. The Hungarians made clear their wish to join COCOM, and went so far as to identify Dr. Zsolt Kohalmi as an "Advisor to the Prime Minister and Special Envoy on COCOM Affairs."

The delegation next met with several representatives of the Alliance of Free Democrats, including Tibor Vidos, the Executive Director, Bertalan Szemere, and Prof. Balint Magyar, a sociologist and historian, and the great-grandson of the Prime Minister of the 1848 revolutionary government of Hungary. The Free Democrats, who had lost the election two days before, presented the political platform they intended to pursue in their role as the "loyal opposition." At noon, State Secretary for the Ministry of Foreign Affairs, Laszlo Kovacs, hosted a luncheon for the delegation. The Hungarian side included representatives from the ministries of industry, trade, foreign affairs, the National Security Board, and the National Property Agency. After a brief visit to the National Gallery of Fine Arts, the delegation departed Budapest for Krakow, Poland.

The delegation arrived at Krakow Airport in the afternoon of Tuesday, April 10 and went directly to the Nowa Huta steel mill in the suburbs of Krakow. After a briefing by Jerzy Knapik, Nowa Huta's recently installed new General Director, the delegation was given a personal tour of the coke battery and agglomeration unit by Ryszard Kaczor, the plant's chief engineer. The steel mill, which has over 700 smokestacks belching tons of sulphur dioxide into the atmosphere each year, was described by Krzysztof Coorlich, a Solidarity environmental expert in Krakow who joined the delegation, as the worst polluter in Krakow. The environmental impact of the plant is discussed in detail in this report. That evening, the Consul General, Michael Barry, accompanied the delegation to dinner. On Wednesday morning, April 11, the delegation toured the Nazi concentration camp of Auschwitz and the nearby death camp of Birkenau. The delegation departed for Warsaw in the early afternoon of April 11.

The delegation was met in Warsaw by the Deputy Chief of Mission, Darryl N. Johnson. That afternoon, the delegation met with Deputy Prime Minister Jan Janowski, Head of the Office of Scientific and Technical Progress, for a general overview of Poland's political and economic reform programs. After the meeting, the delegation returned to the U.S. embassy for a briefing by Ambassador John Davis.

On Thursday, April 12, the delegation met with Deputy Prime Minister and Minister of Finance Leszek Balcerowicz. Balcerowicz, a former communist with a Ph.D. in economics from St. John's University in New York, is the chief architect of the Mazowiecki government's economic reform program. Under this plan, the government has attempted to eliminate most price controls, lowered wage indexation and devalued the zloty and made it convertible.

The delegation next met with Deputy Minister of Foreign Economic Cooperation Andrzej Wojcik, who devoted the hour specifically to technology transfer and export control issues. A luncheon was hosted by Prof. Andrzej Stelmachowski, Marshall (President) of the Senate (the 100-seat upper house) and an expert in agricultural law at the University of Warsaw. The delegation next met with Professor Bronislaw Geremek, Chairman of the Citizens' Parliamentary Club in the Sejm. Prof. Geremek, an internationally recognized scholar of medieval French history and a Sejm deputy, joined Solidarity in 1980 and was arrested and interned in 1981. He is credited with creating the 1989 roundtable discussions between Solidarity and the former communist regime that led to the dramatic political changes in 1989. The delegation next held a press conference with U.S. correspondents.

The day concluded with a meeting with minister of Labor Jacek Kuron. Kuron, an historian from an intelligentsia family, dates his political activism back to 1953. He has spent many years in jail because of his views, the last time in 1985. He ran successfully for a Sejm seat and was appointed Minister of Labor and Social Policy. He has assumed the role of explaining the necessity of economic reform to the public, which includes hosting a weekly television program. He is credited with taking the lead in the creation of a social safety net, including unemployment benefits and job retraining programs, to cushion against the sharpest effects of economic

austerity. Ambassador John Davis hosted a reception for the delegation that evening. The delegation departed Warsaw for Prague the following morning.

The delegation arrived in Prague on the morning of Friday, April 13. At 11:00 a.m., the delegation met with three key members of Civic Forum:

- Jan Urban, a 40-year old intellectual who serves as the head of Civic Forum. Urban lost a teaching position after becoming associated with the Czech dissident movement. He thereafter worked as a bricklayer until 1988 when he helped found an independent news agency known as the East European Information.
- Martin Palous, a 39-year old with a doctorate in the natural sciences. He was a signatory of Charter 77 who now serves as head of the International Relations Department of Civic Forum.
- Ivan Harvel, the brother of President Vaclav Havel. He studied computer science at the University of California at Berkeley, and is now a member of Civic Forum's International Relations Department.

The discussion focused on the upcoming June parliamentary elections and economic reform. After lunch, the delegation met with Jiri Dienstbier, the minister for Foreign Affairs. Dienstbier joined the Communist Party in 1958, but was expelled in 1969 because of his support for the 1968 "Prague Spring" reform movement. After working as a night watchman and stoker, he became a member of Charter 77. Before his appointment as foreign minister, he was press spokesman for Civic Forum. Foreign policy was the focus of this meeting. The Foreign Minister presented Czechoslovakia's ideas on a Pan European security system.

That evening, Ambassador Shirley Temple Black hosted a reception for the delegation, followed by another reception hosted by the Mayor of Prague, Jaroslav Koran. The delegation departed Prague on Sunday, April 15, for Shannon, Ireland, to join Codel Dole for the return trip to the United States. The delegation departed Shannon on Monday, April 16, and arrived back at Andrews Air Force that evening.

The delegation's visit to Eastern Europe had three objectives. The first was to take a first-hand look at the dramatic changes that have occurred in Eastern Europe since Solidarity's stunning victory over the communist party in Poland in June, 1989.

The second objective was to gauge the extent of the problems and prospects for the success of political democracy and economic pluralism in Eastern Europe.

The third objective was to assess the best way to promote permanent economic change through direct, Western private investment and access to Western high technology, and to evaluate U.S. investment and trade opportunities in the area. The following is a brief chronology of key events in Eastern Europe since that time:

- On June 4, 1989, Poland held partially open parliamentary elections that saw Solidarity win 92 seats in the 100-seat Senate. Solidarity also won 160 of 161 available seats in the 460-seat Sejm. Candidates from the Communist Party and allies ran unopposed for the remaining 299 seats, and only 5

received enough votes to win a seat. On June 6, Polish leader Jaruzelski called on Solidarity to join Communists in a coalition government, but Solidarity refused. On June 18, Solidarity captured 7 of 8 unfilled seats in the Senate during a runoff parliamentary election, giving Solidarity 99 out of 100 seats in the Senate. The single unfilled opposition seat in the Sejm was also won by Solidarity, giving it all 161 opposition seats in the lower house.

- On August 7, Bonn refused to expel 130 East Germans who sought refuge at the West German mission in East Berlin. In Budapest, another 180 East Germans took refuge at the West German embassy. On the 19th, more than 900 East Germans fled to Austria during a joint Austrian-Hungarian friendship picnic. On the 23rd, 250 more East Germans crossed from Hungary to Austria. On the 24th, West German Chancellor Kohl requested a meeting with East German leader Honecker. On that same day, 118 East Germans were flown from the Budapest embassy to West Germany.
- On August 21, 3,000 demonstrators in Prague protested on the 21st anniversary of the Warsaw Pact invasion of Czechoslovakia. The demonstration was brutally broken up by the security police, who arrested 370 demonstrators.
- On August 24, Solidarity activist Tadeusz Mazowiecki won parliamentary confirmation as Premier to head a coalition government in Poland.
- On September 10, Hungarian Foreign Minister Gyula Horn announced suspension of the agreement with East Germany requiring Hungary to prevent emigration of East Germans to the West. Within the next three days, 10,500 East Germans passed into Austria and then on to West Germany. By October 1, nearly 30,000 East Germans had left Hungary for the West. Soviet spokesman Gannadi Gerasimov said Hungary's actions "did not directly affect" the Soviet Union.
- On September 19, Hungarian government and opposition representatives reached an accord to create a multiparty system in 1990. Free elections were scheduled for June, 1990.
- On October 7, a special congress of the Hungarian Socialist Worker's Party voted 1,005-159 to change the name of their party to Hungarian Socialist Party, to restructure its party hierarchy, and to adopt a new party program renouncing Marxism in favor of democratic socialism.
- On October 18, the Hungarian National Assembly voted to change the name of the country from "People's Republic of Hungary" to "Republic of Hungary." On the 23rd, Hungary marked the 33rd anniversary of the 1956 uprising, and Hungary's new leaders declared Hungary a free republic.
- On October 28, 10,000 protesters gathered in Prague's Wenceslas Square to mark the 71st anniversary of the founding of the Czechoslovak Republic. Hundreds of riot police charged into the crowd, beating protesters and arresting nearly 400.
- On November 3, an estimated 10,000 protesters demonstrated in Sofia, Bulgaria. On the 10th, Bulgarian leader Zhivkov resigned as president and party general secretary.

- On November 4, a huge pro-democracy demonstration attracting an estimated 500,000 protesters was held in East Berlin. On the 13th, another 200,000 demonstrated in Leipzig demanding free elections.
- Between November 17 and December 1, hundreds of thousands demonstrated in major Czech cities calling for the resignation of communist party members in leading government positions. On November 19, dissident playwright Vaclav Havel led a dissident movement in Prague and agreed to form an umbrella opposition organization, Civic Forum. On the 23rd, Alexander Dubcek, Czechoslovak leader during the "Prague Spring" of 1968, re-emerged to address a crowd of 70,000 in pro-democracy demonstrations in Bratislava, and another 200,000 in Prague the following day. On the 24th, Communist Party leader Milos Jakes and the entire 12-member Politburo resigned. On the 25th, Havel addressed 800,000 people in Prague, leading to the resignation of Premier Ladislav Adamec. On December 1, a new Party Politburo declared that the 1968 Warsaw Pact invasion of Czechoslovakia was illegal.
- On December 14, Czechoslovak Foreign Minister Jiri Dienstbier said at a press conference that the October 1968 agreement allowing Soviet troops to be stationed in Czechoslovakia was signed under duress and was invalid.
- On December 25, Romanian leader Ceausescu and his wife were tried on charges of genocide and embezzlement and were executed by a firing squad.
- On December 28, Vaclav Havel was unanimously elected president of Czechoslovakia by the parliament.

ISSUE AREAS

POLITICAL

The Issue of "Irreversibility"

Are the changes brought about by the political revolutions in Eastern Europe irreversible, or could these countries revert to some form of Communism or other government antithetical to democracy and Western interests? The delegation concluded that the political revolutions have set in motion a democratic process in Eastern Europe through a series of national elections. Political freedoms appear to have been won in the GDR, Poland, Hungary, and Czechoslovakia. However, the most daunting task facing these new democracies is reconstruction and modernization of economies in woeful disrepair, and the survival of the new regimes may well depend on their success. Bronislaw Geremek put it this way: "Political democracy depends on resolving economic problems, including the problem of foreign debt."

While there is in all likelihood "no going back" for these countries, it is by no means given that political stability and steady economic progress will ensue. The economic problems are enormous, as will be discussed below, and failure to solve them could imperil more than one of these governments. Already in Poland there are signs of public impatience with the government. A. M. Rosenthal, in a May 6 column in the New York Times, warned of "Polish Pe-

ronist populism," a possibility that cannot be ruled out there or in the other countries once they move down the path of economic reform.

In the GDR, Poland, Hungary, and Czechoslovakia, the Communists have been neutralized and largely removed from their positions of leadership. Multi-parties have proliferated. In Poland, there are about 100 parties competing for power; in Czechoslovakia there are 30. These nascent multi-parties are undergoing an identity crisis in the process. Solidarity and Civic Forum, for example, are eschewing the label, "political party," for a broader concept, "social movements." During this convulsive transition period, the Communists have assumed the role of the minor opposition, but they nevertheless continue to control important offices in government and state enterprises.

Government.—During the March 18 elections, the Alliance for Germany, a conservative coalition favoring quick unification, won a decisive majority in East Germany's elections. The Alliance for Germany, a three-party bloc formed with the strong support of West German Chancellor Helmut Kohl, includes the Christian Democrats, who won 41 percent of the vote and were led by Lothar De Maiziere who was named Prime Minister, and two smaller parties, the German Social Union and Democratic Awakening. The three-party coalition won 48 percent of the vote. The Social Democrats, formed in October, 1989, won 22 percent of the vote. The Communist Party, which after its fall in November, 1989, changed its name to Party of Democratic Socialism (PDS) to underscore its new commitment to democracy. The PDS received a larger share of the vote than expected, and consequently is certain to remain a credible opposition force if it is able to survive reunification.

Ten months after Solidarity scored its victory over the Communist Party, Poland is still led by a communist President, Wojciech Jaruzelski. In the ministries, Premier Mazowiecki's coalition government still contains communists in charge of defense, interior, foreign trade, and transportation. Solidarity has sought to neutralize the power of the ministers by appointing Solidarity loyalists as deputy ministers. Their primary task is restricting the power of the ministers and paving the way for their removal. The security and armed forces are also increasingly coming under the supervision of Solidarity-appointed officials.

In Hungary, the majority of the seats during the national elections were won by non-communists. The prevailing sentiment was captured in a popular campaign poster pasted in public buildings throughout Budapest which depicted the back of a fat Soviet soldier with the slogan, "Comrades, it's over."

In Czechoslovakia, the Civic Forum interlocutors revealed that the communist party still retains its name, that it will field a slate of candidates for the June 8 parliamentary elections, and possibly win some seats. The slates will need 5 percent of the votes cast to win a seat. In Czechoslovakia, there are 23 political parties running in the elections, with 4 or 5 fielding slates expected to garner the required 5 percent, including Civic Forum, the People's Party, the Christian Democratic Union, the Greens, and the Communist Party. Civic Forum predicted that when the campaign starts, the

communists will have a problem defending their past failed policies.

NOTE.—On June 8, 96 percent of Czech voters turned out for the national elections. The coalition of Civic Forum and the Slovak Public Against Violence won an absolute majority in the Federal assembly with 46 percent of the vote. The Communist Party and the Slovak National Party each won 13 percent while the Christian Democrats won 12 percent. The Greens did not win the necessary 5 percent to be represented in the Assembly. The surprise showing was by the Communist Party.

The Enterprises.—Communists still control the national bureaucracies, public institutions, and key state industries in several of these countries. The Nowa Huta steel mill in Krakow, for example, is still run by former party functionaries and administrators known as "nomenklatura." The new government's major task will be to thin out the bloated bureaucracies and absorb the remaining "nomenklatura" in the new government structure. The challenge to the new governments will remain even after the elections, when civilians are placed in leadership positions, as the old bureaucracy will prove to be resilient.

"Rising above Politics"

One interesting theme that arose in Poland and Czechoslovakia was the distinction between political parties and "political movements." In Czechoslovakia, Civic Forum leader Jan Urban said that after 40 years of communism, the people did not trust politicians, politics, or political parties. Seventy-five percent of Civic Forum's supporters did not want it to become a party. They preferred to be known as a "political movement" or better yet, a "task force." After the June elections, Urban said, Civic Forum was going to hold a congress to decide what it would become. In the meantime, he said, even President Havel had shown a dislike for politics and had pledged not to campaign for Civic Forum slates during the June election. Havel, Urban said, wanted to "rise above politics."

In Poland, Solidarity appeared to be going through the same identity crisis. Geremek said that Solidarity trade union leader, Lech Walesa, viewed Solidarity as a "social movement." Walesa's reluctance initially to enter the presidential race was attributed to his disdain for politics. However, while the delegation was in Poland, Walesa appeared to announce that he would seek the presidency, a move that caused widespread discussion within the country. According to Geremek, however, the announcement "was not for today, but for tomorrow," i.e., 1991. Walesa, he said, wanted Solidarity to give the government one year of political stability to implement its political and economic reform plans. If the period of stability works, and does not block the dynamics of freedom, Geremek said, "O.K." If not, Walesa would probably announce that he was a candidate for the presidency, even though presidential elections were not scheduled until 1994. Geremek predicted a victory for Solidarity. Referring to a recent poll, he said that Solidarity would get 56 percent of the vote compared to 10 percent for the other political parties. Thirty-four percent did not express a preference, which Geremek called, "indifference."

In Hungary, this distinction was less evident. In the lengthy meeting with Joszef Antall, he discussed the election results as having fallen short of the necessary two-thirds majority he would need to implement the HDF's program. The HDF, he said, gained 43 percent of the vote, and, after putting together a coalition with the Smallholder's Party and Christian Democrats, the majority vote would be around 60 percent. When asked what Hungary's priorities were, especially those that would affect foreign investment in Hungary, Antall replied that the HDF faced a "technical problem," the lack of a two-thirds majority to make the needed amendments to the constitution concerning legislation on financial matters, i.e., the budget. Failure to change that, he said, "could paralyze the government." The removal of a number of laws that are obstacles to a free market economy are a top priority for his government.

Antall clearly recognized the political realities in Hungary. The following day, the delegation met with leading representatives of the Alliance for Free Democrats, who had garnered 24 percent of the vote. Balint Magyar, the group's spokesman, said that the Free Democrats "did not agree with the HDF's proposal to change the two-thirds rule on voting, the budget, freedom of the press, and local elections." The Free Democrats pledged to "follow a responsible attitude, and not oppose the HDF for opposition's own sake."

It is unclear where the identity crisis will lead Civic Forum and Solidarity. One U.S. scholar believes that it may well lead to the formation of a number of splinter groups unless Walesa and Havel take a more active political role. The Hungarian Democratic Forum, in contrast, does not appear to suffer from the same problem. Nonetheless, in all three countries, the "political market place" may well find the political parties competing for public support across a broad spectrum of interests endemic to Eastern Europe such as rural-urban divisions, traditionalists v. the new breed, socialists v. capitalists, and so on. The most divisive splits, however, may well be along religious and ethnic lines. It is unrealistic to assume that these nascent democracies will be able to avoid divisions that are common elsewhere and which were common in this part of Europe before Communism suppressed them more than 40 years ago. One of the dangers Eastern Europe faces is the reemergence of old ethnic, linguistic and nationalist conflicts.

ECONOMIC

Introduction

The failure of Marxist economics is one of the primary reasons for the political revolutions in Eastern Europe. But, as with the political problems apparent in the transition to democratic political systems, these countries face enormous economic problems that include industrial obsolescence, stagnant production, foreign indebtedness (Poland and Hungary), distorted and inefficient centrally planned economies, irrational pricing systems, and environmental blight. At present, the GDR, Poland, Hungary, and Czechoslovakia lack the resources, both human and financial, to address the plethora of economic problems that helped bring about the political revolutions.

How to avoid social and political instability during the implementation phase of the economic reform programs, particularly the privatization of state enterprises, was the sticky question uppermost in the minds of the leaders the delegation met in each country. The GDR called for immediate and decisive action on the part of the government. In Poland, the leaders had decided to bite the bullet and implement a radical and swift break with state control. Hungary, in contrast, appears to be opting for a slower, more gradual approach to privatization. Czechoslovakia has yet to make up its mind, although it is more likely to follow the Hungarian model.

The four countries' officials were prepared to allow the less efficient state enterprises to go bankrupt if necessary. They displayed an awareness that economic reform would also lead, initially, to a lower standard of living, and they believed that their people were prepared to accept an initial period of hardship. What was unclear was how long the people would tolerate a lack of progress and demonstrable improvement in their standard of living.

The delegation's discussion focussed on the following issues in the four countries:

- The pace and extent of privatization, unemployment, price reform, external debt, and credit markets.
- The potential role of foreign investment.
- The need for technical assistance.
- Strategic trade.
- Special needs of each country.

GERMAN DEMOCRATIC REPUBLIC

Privatization and Unemployment

CDU (West) representative Elmar Pieroth said that the GDR lacked small and medium-sized businesses and needs 500,000 of them to generate 4 million new jobs to make the GDR's economy competitive with the FRG. The solution, he argued, lies in the disappearance of the state's foreign trade monopoly and "quick privatization," management training, and a restructuring of state-owned combines. The entire process must occur within 24 months to succeed. Sixty percent of the people working for state enterprises are not needed and ought to be retrained to work in small and medium-sized businesses. The economy needs another 900,000 craftsmen to augment the 400,000 already active in the GDR.

In addition, Pieroth said attention should be given to maintaining Soviet and other CEMA trade relations as a means of ensuring employment. There is also a need for training and retraining, including on-the-job training. The government had to motivate the emerging business class in order to prevent political and economic problems, and it had to act to get rid of old administrative structures as well. How these changes will be taken in the light of impending economic union with the FRG remains unclear. Pieroth's proposals, while no doubt meritorious, imply some period of time for them to be undertaken. Economic union will likely mean, among other things, economic "invasion" by the FRG which could complicate the achievement of these objectives.

Financial Issues

On April 9, the delegation met with State Bank Acting President Geissler who discussed the GDR's banking reform program, including exchange rates under monetary union with the FRG. This was the first such discussion with a U.S. delegation.

The Banking System.—The GDR's banking system was to be reorganized along the lines of the banking system in the FRG. As of April 11, the State Bank had become fully independent and its branch operations converted into a market-oriented commercial bank system. The State Bank included the main central bank with 14 regional banks and 2,000 employees.

The State Bank's principal responsibilities include monetary policy, the security of system reserves, refinancing commercial banks, holding government cash balances, and managing monetary flows domestically and abroad. The State Bank was also responsible for bank supervision and for authorizing the opening of branches. Because it was now independent, the State Bank no longer belonged to the Council of Ministers.

The structure of the new State Bank is as follows:

- 190 local savings banks were established with about 18,000 employees. These banks offer services in East Marks and foreign currencies.
- 120 "People's Banks," similar to credit unions, operated on a cooperative basis.
- 14 branches of the National Agricultural and Foodstuffs Bank were to be reorganized into the German Cooperative Bank of Berlin.
- 160 branches of cooperative institutions with trade and banking functions will merge with other cooperatives to become strongly capitalized banks operating in local area within the GDR.
- The German Foreign Trade Bank will see its functions change by having to compete for its international and foreign trade business.
- The GDR Trade Bank will continue to function for "special" foreign trade operations.
- The State Bank's newly independent commercial operations, employing 10,000 will split into two banks. On April 19, the Berlin City Bank will become a joint stock company while the General State Bank branches have been transformed into the German Credit Bank with 9,500 employees.

Monetary Union.—The delegation asked for comments on the likely exchange rate between the Deutsche Mark (DM) and East Mark (EM) under monetary union. Geissler said that savings had to be separated from enterprise finances, which could incorporate a 2:1 rate in some aspects. He said savings had to be at 1:1 and that per capita savings in the GDR were a fraction (M12-14,000 on average) compared to the FRG (DM40,000). These savings, he said, were backed by solid investments, including state-owned housing. He concluded that with such backing 1:1 was fully justified.

Geissler argued that a careful reading of remarks by Bundesbank President Poehl were reassuring, given that Poehl's 2:1 formula still left the door open for the use of savings to purchase

shares of state-owned enterprises. Geissler expressed his conviction that such an option would satisfy the people, although subsequent events have raised some doubt about that.

Inflation.—The delegation asked about inflation under economic and monetary union. Geissler downplayed the danger, arguing that any excess purchasing power on the part of GDR consumers had been exaggerated. The M20-30 billion of "overhang" was in a manageable proportion to the GDR's annual retail turnover of M160 billion. Moreover, this overhang was focused on specific goods, including housing, housing repairs, travel, and cars, rather than on general consumer supplies. Geissler said that supplies in the FRG and in Western Europe would easily service any surge in demand in the GDR.

Privatization of Banks.—The delegation raised the issue of the privatization of banks under the new system. Geissler said that all banks were presently state-owned and would remain so. However, there were plans to convert the system into joint stock or limited liability companies. Recent legislation had established a state trusteeship or trust company to hold all state assets and to manage the transfer of such assets into private hands. The precise guidelines on the sales of shares to the private sector remained to be resolved through further legislative action by the Volkskammer. He expressed some caution, however, on the purchase of state properties by foreigners.

Property issues and ownership are contentious issues. One view was that the trusteeship was likely to avoid quick decisions. Geissler suggested that one solution to the problem of converting savings under monetary union would be to issue treasury bills, backed by trusteeship holdings, perhaps against the outstanding savings total. The government had kept silent on such a sensitive issue in the interest of finding productive solutions. As with the other issues discussed, the impact of economic unification on GDR planning is a major uncertainty.

Foreign Banks in the GDR.—According to Geissler, the prospects for foreign banks operating in the GDR were encouraging. The GDR's economic future depended on support from the West, including management and financial advice. Geissler stated that the State Bank would complete its proposal for a new law on foreign subsidiaries in the financial sector—banking, insurance, and other financial services—by the end of April or early May with every expectation of prompt Volkskammer action. Given property concerns, foreign banks would probably have to invest in new capital increases, rather than purchasing existing assets. In practical terms, the law would focus on the future, opening the door to foreign banks to operate in DM. Involvement of foreign banks in Ostmarks, with monetary union so near on the horizon, would be an administrative nightmare.

Agriculture

According to Eberhard Wiedermann from the CDU-East, the GDR had introduced a new agriculture policy in November 1989, that will displace nearly 500,000 of the 700,000 people now employed in the agricultural sector. Those displaced, mostly mechan-

ics or administrative personnel, could easily find employment in the services or light industrial sectors, according to Wiedermann.

The delegation asked how the continuation of the cooperative structure would both benefit agricultural efficiency and also lead to the displacement of so many farmers. Weidermann said that some restructuring was necessary. For example, there was a need to organize livestock and plant production together within cooperatives as opposed to the previous arrangement which largely separated the two. The size of cooperative farms would depend on the desires of the farmers, with the optimal size of the cooperatives put at around 1,000-1,500 hectares.

Emigration

The delegation asked about the anticipated political consequences of continued emigration to the West and rising unemployment on the upcoming elections in December, and what impact the GDR's economic problems would have on foreign investors. Pieroth said that political and economic problems could be prevented by the government's "decisive action" and a "quick start" of small and medium-sized businesses. Pieroth was not hopeful that those that had emigrated to the FRG would return, especially those with skills. Those that choose to return would need the "pioneer spirit" to remain.

Strategic Trade

The delegation expressed its concern over the large volume of trade between the GDR and the Soviet Union and the implications of this trade on the diversion or illegal purchase of controlled Western technology. The delegation emphasized that the U.S. did not want U.S. high technology to end up in the Soviet Union. Pieroth said that controls on militarily critical technologies should be limited to a "very few" areas. It was, he said, in U.S.-German interests to see the Soviet Union succeed in "perestroika," even if this success depended on Western high technology. "It is now in the GDR's interest," Pieroth said, "to give high technology to the Soviet Union."

Regarding the China Greenline, a list of 39 high tech areas available to China from COCOM countries with a minimum of licensing requirements, Pieroth said that the "notion of a green line does not mean anything to [him]; therefore, there was no concept of a control system" inherent in the thinking of this key GDR policymaker. He said a system could be worked out to prevent high technology from reaching the Soviet Union for military arms purposes, but high technology was needed to build up the Soviet economy. The unification of Germany, Pieroth said, would see the problem "disappear." However, during the transition period, he saw a need for controls but did not elaborate. The GDR, Pieroth said, cannot allow European industries to be pressured by U.S. industries regarding the need to prohibit transfer of high technology.

The delegation said that some in the U.S. Congress view Soviet President Gorbachev differently than the GDR does, believing that it is better to be more cautious, rather than more open, regarding high technology. The GDR officials agreed that Gorbachev had not made the economic reforms needed in the Soviet Union, but they

also believed that it was necessary to give Gorbachev the technology he needed. If Gorbachev failed, this would increase the chances of failure in the Soviet Union and exacerbate East-West tensions.

At the luncheon with representatives of the GDR high technology community, it became clear that the GDR is already exporting to the USSR technology that is above COCOM's level of control. While their computers may not be fully up to Western standards and the production process may not be economical or competitive in Western terms, this activity poses a major problem for COCOM. Any effort to block it, which would in theory occur with unification in the absence of any negotiated change in control levels, would cause GDR companies to lose their primary source of revenue and would threaten loss of critical technology to the Soviets is simply not a politically acceptable outcome to the Germans and Soviets. Since the events in Eastern Europe do not mean the potential Soviet threat to Western interests has vanished, the need for COCOM's control mechanism clearly remains, even if high tech trade continues through East Germany. The luncheon demonstrated the need for substantial streamlining and rationalization of the COCOM list, but it did not remove the rationale for such a system.

The Environment

The delegation asked what priority the GDR places on the environment, noting that it had visited Bitterfeld, a chemical plant about 90 minutes south of Berlin. The GDR officials said that while there was "no industrial priority list," some plants had been closed for environmental reasons. When asked how much it would cost to clean up the environment, the GDR officials said that it was not possible to talk about amounts. It would take generations, they said, to clear the ground to make it fertile again. The GDR would welcome investments in clean technology. The new government would have to start from scratch to develop a plan to clean the environment.

The Visit to Bitterfeld.—On April 7, the delegation was given a personal tour of the GDR chemical and coal mining center of Bitterfeld. Bitterfeld's chemical industry employs 21,000 people. The guide was 45-year old Hans Zimmermann, who was born and raised in Bitterfeld and had devoted his life to cleaning up the city. While he has been considered a dissident by the Communism regime, during the March 18 elections, he was elected to the Parliament as a Christian Democrat. He said he worked 16-hour days at the newly established Environmental Institute in Bitterfeld.

Mr. Zimmermann was a veritable walking book of statistics. By way of overview, he said the city's environmental blight was the result of the open-pit lignite coal mine and the chemical plant. The city's chemical production dated back to the first World War, and continued during the second World War. He made the following observations about Bitterfeld:

- A lignite-fired power plant pours sulphur dioxide into the atmosphere as it generates electricity to run the city's energy-intensive and inefficient chemical and alumina plants.
- Dust pollution is caused by an open pit lignite mine on the edge of the city. The mine remains in operation because it draws hard currency from the amber discovered there, not the

lignite. This mine is scheduled to be closed in August, 1990, a decision made after the March elections.

- Toxic sludge, still bubbling with chemical reactions, originates in the chemical plant and is piped into a holding tank through plastic and ceramic pipelines (to prevent corrosion). The toxic sludge is dumped, untreated, into the Mulde River, a tributary of the Elbe, which itself empties into the Baltic Sea. The plant accounts for 49 percent of the effluent dumped into the Julde immediately downstream from Bitterfeld.
- Most of the once-yellow buildings in Bitterfeld are now covered by a thick layer of black deposit. Only partly facetiously, Zimmerman said that the acid rain was a blessing in disguise as it was starting to clean some of the buildings.
- A handicapped children's home is located between a so-called, "silver lake," which is filled with foaming chemicals from the Orwo film plant located in the adjoining town of Wolfen that feed directly into the Mulde River, and Bitterfeld effluent canals. Chemicals must be pumped out of the basement of the home daily.
- The Mulde's wetlands were once home to unusual wildlife which disappeared after the water table was lowered and pumped out to dig the lignite coal mine.

Zimmerman said that the Institute could not measure the extent of the contamination of the city's potable water supply due to a lack of measuring equipment. Where once the water was used to brew beer, the brewery is now closed because of the contaminated water table. He estimated that it would cost DM500 billion to clean up Bitterfeld. (The West German Institute for Economic Research estimates that it could cost \$200 billion in the next 20 years to clean up East Germany's environmental blight). The GDR's new government has decided to keep Bitterfeld's chemical plant operational. Zimmerman expressed the hope that the decision would give investors confidence to invest in Bitterfeld.

U.S. Role

According to the U.S. embassy, the GDR is the most successful socialist state in Eastern Europe with a living standard equal to Spain. The embassy said the investment climate was "good," but that the "wait and see" attitude apparent in visits from U.S. businesses could cause the U.S. to lose out in investment opportunities in the GDR. At the same time, it is clear that the GDR is a special case among the four countries the delegation visited, because of the likelihood of economic and political union with the FRG. Though that will be a rockier and more expensive process than is currently realized, it will doubtless occur, and future U.S.-GDR relations will be determined by U.S.-FRG and U.S.-EC relations.

Regarding preference for the U.S. in the face of EC-92, GDR officials said that the FRG did "not want Fortress Europe," and that the two Germany's "were the free traders." However, the official conceded that regional businesses had more of an interest in the area than did foreigners. Cultural and geographic proximity, especially with the FRG, would lead to more investment from Western Europe than from non-European countries. Nonetheless, the GDR would like to see foreign capital in Germany.

HUNGARY

Privatization

According to incoming Prime Minister Antall, the major goals of the new parliament are to elect a new head of state, and then to create a new government. The chief goal of his administration will be to carry out privatization under the best circumstances and in the most favorable manner. The problem was very serious: 90% of all enterprises in Hungary are state-owned. In the next few years, the new government's target will be to reduce the state's ownership to 30%. According to one of Antall's economic advisors, spontaneous privatization could raise serious problems. In the past, apparently some state enterprises sold out to private investors at an unrealistically low price, allegedly in return for protecting the current managers' jobs. To protect against this "abuse," a new State Property Agency was created.

At the same time, the privatization process is essential to economic reform. For example, the delegation pointed out that the steel industry in Hungary has 70,000 workers, the same number it had 15 years ago. In the U.S., there were more than 300,000 workers 15 years ago, but today there are only 120,000 producing nearly the same amount of steel. The delegation said it foresaw problems of unemployment in Hungary and hoped that Hungary's political will would see it through the inevitable tough times.

The Alliance for Free Democrats disagreed with the HDF over the pace and extent of privatization needed in Hungary. Following the Polish example, the Free Democrats prefer a "speed up of privatization," and not the 5-6 year-plan favored by the incoming government. The Free Democrats charged that the HDF's position had changed during the election campaign from a quick to a slow pace of privatization. The HDF, the Free Democrats charged, would liberalize the economy but were committed to continued strong control over it. In contrast, the Free Democrats favored the creation of a legal institutional framework over privatization, but without interference from local administrative bodies.

The Free Democrats admitted that no one in Hungary had a clear blueprint on the issue of privatization. There were only "partial concepts" over how to deal with the enterprises under state control. However, the lack of legislation, lack of capital markets, and lack of accounting for assets presented a real problem for the privatization process. As for privatization leading to unemployment, the Free Democrats argued that the service sector infrastructure was underdeveloped and could absorb those displaced in other sectors.

The problem in Hungary, said the Free Democrats, is that the people do not know what a free market system is, and the consequences of conversion to such a system were, for example, not an issue during the election campaign. Regardless of how this policy debate evolves, it is clear that with the victory of the HDF, the pace of economic reform will be slower than in Poland. This will create an interesting alternative model for other countries to consider, along with Poland's, but it is impossible to predict at this point which is the more likely to succeed.

Foreign Debt

Antall placed Hungary's foreign debt at \$21 billion, of which 40 percent was held by Japan and 30 percent by the FRG. Hungary's debt service is very high on a per capita basis. While Hungary has adopted meeting all obligations as its first principle, and is not looking for debt rescheduling at this time, it does want to discuss the problem of its heavy debt burden with all creditors.

According to Antal's economic advisors, the balance of payment problem and foreign debt are serious. Hungary, he said, "had no capital markets; the land value was zero. Market prices were distorted; superficial prices were endemic." These market problems, he concluded, would force the State to intervene with subsidies, favorable taxes, quotas, etc., as corrective measures.

The HDF, the Free Democrats alleged, had made good use of recent credits, IMF loans, hard currency export proceeds (up by 18% over last year), to support strong economic growth, and pave the way for the HDF's victory. The Free Democrats also alleged that, contrary to HDF statements in support of debt-for-equity swaps, the HDF was opposed to all forms of debt swaps because of their concerns with selling the national patrimony too cheaply. That truth of that allegation remains to be seen.

Foreign Investment

The delegation asked Antal what measures Hungary would adopt to facilitate the climate for foreign investment. Antal replied that amending the constitution to facilitate foreign investment and other economic measures was crucial to the success of the economic reform program. He said that the constitution required $\frac{2}{3}$ vote for the removal of a number of laws that were obstacles to the establishment of a free market economy, but that the coalition government forged by the Hungarian Democratic Forum controlled only 60 percent of the votes.

The Free Democrats charged that the HDF favored German (FRG) connections with Hungary for historical and cultural reasons. The Free Democrats, on the other hand, favored broadening "Anglo-Saxon" contacts. When asked if foreign investment should be encouraged, the Free Democrats replied that this was an issue that went beyond nationalities. They argued that Hungary was not hostile to foreign investment. Hungary's taxation laws were more than generous toward foreign investors. When asked, they pointed out that the General Electric-Tungsram light-bulb manufacturing joint venture had not become an issue, perhaps in part because it was unclear how much Tungsram's assets were worth. They were not hostile to foreign investment, they asserted, countering a charge brought by the HDF against the Free Democrat's during the election campaign.

Price Reform

One Hungarian official said that if Hungary wants to restructure its economy, it needs to invest more money in it. The price system, he said, is completely artificial. Hungary needs to liberalize its market but fears the problem of switching from a CMEA-market country to a global market. To meet its balance of payment prob-

lem, Hungary, this official said, would require additional money and new credits.

Strategic Trade

Antall thanked Senator Heinz for introducing S. 2113, a bill to facilitate direct private investment and relax export control restrictions toward Eastern Europe. He said that during a recent visit to the U.S. he had discussed technology transfer issues with Deputy Secretary Eagleburger, but did not elaborate, saying that the issue would be discussed at length the following day with government experts. The delegation, however, said that it was important for Hungary to succeed economically as much for itself as well as for the prospects for economic change in the Soviet Union. Hungary's success could strengthen those in the Soviet Union who favor the same course.

Regarding technology transfer, the delegation told Antal that many in the United States wanted to give Hungary access to Western technology, but there were two reservations. First was the need to retain control over technology transferred to Hungary that could be diverted to the Soviet Union. For this reason, there was a need to differentiate between the Eastern European democracies and the Soviet Union. Second, Hungary was a conduit for front organizations that sought to obtain illegally Western technologies. It was important to U.S. security and U.S. security agencies to eliminate those illegal activities. The delegation, however, was cognizant that Hungary had a good record of not diverting technology purchased legally, and for this reason, the delegation expressed the hope that Hungary would be able to meet this additional challenge.

Antall said that the democratic transition in Hungary should provide the U.S. with the guarantee that Hungary would protect U.S. technology. Hungary's new legal system, he said, will also reflect this policy. Antal expressed the hope that COCOM would remove Hungary from the proscribed-countries list. Hungary also wanted to see a reduction in the number of items on the COCOM list by removing the less sensitive and less essential items required for national security purposes. A new government would be formed in late May, at which time it would take inventory of what assurances Hungary could give the U.S. on the protection of Western technology.

The delegation said that Hungary's eventual membership in COCOM would depend on a number of factors: its relationship to the Soviet Union; its political choices regarding Comecon and the Warsaw Pact; and the development of our bilateral relationship during the transition period. In the interim, the delegation was optimistic that the U.S. would negotiate a higher level of technology that could be transferred to Hungary. Hungarian comments and willingness to make commitments would be reported to President Bush after the Heinz delegation's return to Washington.

The delegation reiterated that members of the Senate had spent a great deal of time working to prevent the Soviet Union from acquiring illegally Western technology, and that this was one of the causes of the large defense budget we had sustained for many years. So while members of Congress were encouraged by the events in Eastern Europe, Hungary should understand why they

have reservations toward relaxing controls toward the Soviet Union. Members of the delegation indicated their approval of what Gorbachev is saying, but they would like to see concrete changes, especially in reductions in military spending, before reassessing the strategic threat. Therefore, there is a need to be careful about technology transfer to the Soviet Union. On the other hand, COCOM could shorten its control list to help Hungary and other emerging democracies in Eastern Europe.

On Hungarian official asked the delegation to keep two things in mind. First, the elections had changed Hungary. It now shares the same system and values as the U.S. and other democratic countries. As a result, Hungary was waiting and expecting recognition from Western countries and should be given the same status as other friendly countries outside NATO. Hungary, on its part, has to examine the legal obligations of the past Hungarian government to Comecon and the Warsaw Pact. Second, the Hungarian government will give assurances on the the legal acquisition of technologies. At the same time, it is necessary to reduce the COCOM control list.

Technology Transfer Roundups.—On April 10, the delegation participated in a roundtable discussion on technology transfer issues at the Ministry of Industry. The Hungarian side was led by Laszlo Pal, State Secretary, Ministry of Industry, Dr. Zsolt Kohalmi, Advisor to the Prime Minister and Special Envoy to COCOM, and other officials from the Ministry of Trade, Foreign Affairs, Customs Service, and Justice. Pal is a member of the Socialist Party elected to Parliament.

Pal outlined an agenda for the roundtable, including discussion of a safeguard regime to protect Western technology, the desire for a license free zone for Hungary comparable to the COCOM license free zone under discussion at COCOM, COM as an obstacle to joint ventures in Hungary, and the pending arrival of a briefing team from the U.S. Department of Commerce to commence negotiations between the two governments on a COCOM-approved strategic trade agreement. Pal also thanked Senator Heinz for sponsoring a bill (S. 2113) to relax export controls toward Eastern Europe.

After a 20 minute video depicting the backward state of technology in Hungary, especially in the telecommunications sector, Kohalmi made the following points:

- In the mid-60s, Hungary went through a "stage of enlightenment" when it introduced a market economy. At this time, technology targets were set.
- In the 70s, the U.S. government brought real and justified charges against Hungary's illegal acquisition of Western technologies. These cases involved unlicensed imports that in the end did not benefit Hungary's industry. Hungary paid above-market prices for the illegally obtained commodities and in many instances could not obtain spare parts for them. "Technology theft was not the way," Pal said.
- Hungary is now in the "Era of Cooperation." Mutual trust is needed. The technology theft program has been "suspended." The Hungarian government will cooperate on re-exports, unauthorized end-uses, and provide the U.S. with technology safeguard guarantees.

- Key sectors include telecommunications, banking, civil aviation, and machine tools (need for controllers). Very specific information was provided on equipment and technologies needed by Hungary, as follows:
 - X-25 package switching network (hardware and software interfacing on PC, on mini, and on mainframe level).
 - Mainframe computers (substantially increased limits of operational speed and main memory).
 - Disks and backup memories (substantial increase in storage capacities and decrease in access time).
 - Multiplexers (higher data transfer capacity).
 - Network controller software (advanced versions, higher performance).
 - Higher performance CPUs.
 - Front-end processors (high capacity data transfer).
 - Dual processor computers.
 - Software development tools.
 - Single mode optical cables (140 Mbit), optical devices and multiplexes (1300 MM, 1550 MM).
 - Digital microwave communications systems (4, 6, 11, 20, 40 GHZ, 64 QAM modulation, 140 Mbit).
 - ISDN interfaces, hardware and software elements.
 - Measuring instruments for the above systems (1300–1550 MM, 140 MBS).
 - Digital telephone exchanges, data transfer and package switching networks.
 - No. 7 digital common channel signalling (delivery and technology transfer).
 - Cellular 900 MHZ digital mobile radio telephone systems.
 - Message handling systems and networks.
 - Civil aviation (request for changes in security agreement to allow Malev Hungarian Airlines to repair, replace equipment in Hungary).

Delegation's Response.—The delegation informed the Hungarians that technology theft was the administration's and the Congress' major reservation regarding the relaxation of export controls toward Eastern Europe. The delegation conceded that Hungary had made a good effort to protect Western technologies acquired legally from diversion.

While U.S. policy was evolving toward a liberalization of export controls toward the emerging democracies of Eastern Europe, a differential had to be maintained toward the Soviet Union. The Soviet Union has not made the necessary political and military changes to make irreversible the values and practices of military competition of the Cold War, the potential for belligerent behavior toward its neighbors could be seen in Soviet behavior toward Lithuania. The delegation said it wanted to be "very candid" regarding U.S. export control policy toward the Soviet Union. The U.S. was pleased and excited by what is happening in Hungary and other places, but unlike *Time* magazine, some in the U.S. Congress were not willing to make Gorbachev the Man of the Decade. Basic changes have not occurred in the Soviet Union. Strategic nuclear weapons continue to be modernized. Despite START negotiations, the Soviet Union has increased its mobile missiles, especially the SS-25s.

The U.S. had spent billions defending against U.S. technology illegally obtained by or diverted to the Soviet Union. Regarding illegal diversions, however, it should be realized that more than 50% of COCOM's violations have come from COCOM members. This fact should serve as the basis for understanding U.S. skepticism regarding the positive remarks made by the newly emerging democracies of Eastern Europe. Indeed, the People's Republic of China continues to acquire technology cheaper and easier. In sum, while many in the U.S. Congress want to support liberalization for Hungary, especially to modernize its backward telephone system, well-demonstrated by the video that was shown, Hungary, as well as other Eastern European democracies, should also understand the position of those in the U.S. Congress who do not trust the Soviet Union.

The delegation asked the Hungarians to comment on two questions:

1. How is it possible to find out what efforts the Soviet Union continues to make to acquire technology illegally?

2. What legal basis does Hungary anticipate will be established to protect against the illegal transfer of technology?

Liberalization, the delegation continued, would probably occur in two phases. First, the decontrol of technologies in the China Green-line. Second, the establishment of a "yellow zone," which would contain technologies below the general exceptions levels established by COCOM, i.e., the "red zone" listing the most sophisticated militarily critical technologies. The delegation emphasized that it was important for the U.S. and its COCOM partners to be able to track the sale of legally obtained "yellow zone" technologies. The delegation noted that it would become difficult to track illegal diversions because of the anticipated increase in legal sales. Thus, how the pattern of illegal diversions was broken is very important.

Hungarian Response.—Pal said he understood the uncertainties and reservations expressed by the delegation and said Hungary needed to adopt gradual progressive steps to address the issue of technology theft. The situation, he said, was moving quickly; 1989 accelerated events beyond anyone's thinking.

Hungary, Pal said, was not asking for a full exemption from COCOM; only an exemption for the purchase of dual-use items. The technology Hungary was seeking was for commercial and economic purposes. Indeed, Hungary's military industry was undergoing a transformation as well. There would be no more agreements with CEMA after 1991, for example, and from now on, the country's military/industrial activities would be conducted openly.

Hungary's relationship with the Soviet Union is evolving as well, Pal said, as his government takes steps toward complete independence from the Soviet Union. For example, he cited the agreement to withdraw all Soviet troops from Hungary by mid-1991, making the point that the shift from military cooperation was moving quickly to affect political cooperation as well.

Regarding legislation to punish violations of Hungarian export control laws, Pal said that the Ministry of Justice was working on a law to prevent illegal diversions and other related violations. The Ministry of Trade was also working to improve its commercial licensing system. Customs was working on regulations domestically as well as internationally.

Pal said that the Hungarian Customs Service had initiated talks with the U.S. Customs Service in 1987 and held the first round of negotiations on April 2-6, 1990. The negotiations were based on a U.S. proposal. Hungary, he said, had not identified any major problems with the U.S. draft proposal, and had, in fact, satisfactorily completed half of the proposal during the first round of talks. The two sides had identified the scope of cooperation between the U.S. and Hungary and between Hungary and other countries, including COCOM countries. The Hungarian delegation had concluded that they could "fully comply" with "all" U.S. Customs demands. The delegation expressed its satisfaction with the briefing and the results.

During the meeting with the Free Democrats, they said that it was in Hungary's interest to obtain technology from the U.S. and the West. Accordingly, they agreed that it was necessary to protect the technology and that the Free Democrats would also abide by the agreements signed by the Hungarian government. However, as far as identifying former Soviet front companies in Hungary, they said that prior relations were centrally-planned and directed, and conducted at very high levels, implying that they did not know how to go about identifying the companies or individuals who had cooperated with the Soviets before the ouster of the communist government in Hungary.

It was apparent from all the delegation's meetings that Hungary is the farthest advanced of the four countries visited in its awareness of Western technology transfer controls, its appreciation of the role advanced technology plays in economic modernization, its understanding of what steps are needed to permit a greater flow of technology, and its willingness to take those steps.

U.S. Presence in Europe

Antall said that during a recent visit to the U.S. he told the President that the U.S. presence in Europe is important, and that Hungary will seek membership in the EC. The U.S. presence in Central Europe is also very important, and Antall made clear that he favored both a military and economic U.S. presence in Europe. When the delegation asked if he favored NATO's presence in Europe, he replied, "Exactly."

POLAND

Status of Economic Reform Program

According to Deputy Prime Minister and Finance Minister Balcerowicz, the recession in Poland worries Polish officials, but he reiterated that Poland was not going to respond to the recession by relaxing the macroeconomic policy adopted as the centerpiece of economic reform. The recession was the price Poland had to pay for fundamental economic reform. The Mazowiecki government, he said, inherited the recession, along with high inflation, chronic shortages, and a fundamental need to restructure the economy.

Balcerowicz said the choice the government faced was either to tolerate inflation and make institutional changes or adopt a major reform program. The government decided on a policy of macroeconomic reform that included abolishing the old multiple exchange

rates and replacing them with a convertible currency at a stable exchange rate. In addition, Poland increased prices for energy closer to world levels and liberalized other prices for goods and services. Ten percent of all items were now under price control compared to 50% before the policy was adopted. Inflation was brought under control through a variety of measures, including wage restraints, blocking excessive wage increases, reducing wages, and restricting credit. As a result, inflation dropped from 70% in January to below 5% in March, 1990. Lines have "almost" disappeared. Unemployment is around 2%, but it is starting to have a worrisome effect on the people.

Balcerowicz said that despite the "encouraging results," the stabilization process has produced some shock because of the change in real prices and the drop in demand. State enterprises started giving employees paid and unpaid vacations.

It is apparent the Poles have embarked on a courageous course, the success of which is uncertain. By attempting to do everything at once, they are gambling that their economic infrastructure and social fabric will be able to withstand the shocks that will inevitably occur. As noted above, there are already signs of some stress developing. It is obviously in our interest to see this experiment succeed because it will reaffirm the validity of democratic principles and free market economic policies. At the same time, however, there are limitations on what outside government influence can do. The most useful—and lasting—form of support is foreign private sector investment in Poland. In that regard, while some potential investors will be influenced by ethnic ties or a desire to make a contribution during this exciting period, the vast majority will base their investing decisions on hard economic realities. Therefore, the way the Poles handle privatization and the law they promulgate on foreign investment will be critical to their success.

Privatization and Unemployment

Balcerowicz said Poland anticipates that the process of demonopolization will take a long time. Parliament, however, has accepted a new anti-monopoly law. He said he did not agree with the Hungarian experience, preferring to move faster than Hungary. In Poland, the state owns 80% of all assets. Thus, the first step in the demonopolization process is the "small" privatization of smaller assets such as selling or leasing shops and apartments. The biggest problem will be the privatization of medium and large enterprises. In this regard, he said there are four possibilities:

1. Turn state enterprises into joint cooperatives.
2. Liquidate state enterprises legally and then sell or lease the assets partially or wholly.
3. Liquidate by different legal means those enterprises that cannot pay taxes, etc.
4. Institute bankruptcy procedures wherever necessary.

Poland, he said, does not have the legal basis or national laws necessary to accomplish the four possibilities listed above, but laws have been submitted to the Parliament. Solidarity, he continued, understands that an economy based on a private economy is sound. Resistance is not to the basic policy, but to some of its concrete effects. The government is attempting to increase preferential treat-

ment for the workers, but this can be seen as discriminating against non-union workers.

At a later meeting, the delegation asked Deputy Minister of Foreign Economic Cooperation Andrzej Wojcik if privatization extended to steel mills, shipyards, and the banking sector, among other areas. Wojcik said privatization would initially extend to the banking sector. For example, there are plans to privatize Poland's Bank of Export Development. There was also a draft plan for privatizing public utilities. The monopoly over telecommunications may also end, but the telephone system may not be privatized, although some aspects such as cellular phones may go private.

The delegation raised the issue of unemployment in general, and Nowa Huta in particular. The delegation informed Balcerowicz that it had raised the issue of unemployment with the steel plant's management, which had responded that it will find new jobs for those displaced by the reforms and that no one would lose his job. Polish government leaders in Warsaw took a more realistic view, admitting that in the Nowa Huta example in fact some workers would lose their jobs. The concentration of workers in plants such as Nowa Huta would hurt because of the anticipated layoffs.

Foreign Investment and Foreign Debt

Privatization, Balcerowicz said, will require assistance from foreign investment. He said there is a fear that privatization will lead to an increase in taxes to service Poland's foreign debt. That debt is currently \$40 billion, three-fourths which is official debt while one-fourth is owed to commercial banks. He said he realized that Poland must liberalize its law on the transfer of profits, but it must be done in relation to the balance of payments: a link exists between the debt problem, foreign investment, and domestic debt.

The delegation raised U.S. business concerns over Poland's bureaucracy and its relation to foreign investment. For example, the delegation said it had learned from U.S. firms seeking to do business in Poland that it takes weeks to get documents notarized. The delegation suggested that there was a need to concentrate on short-term reforms, especially in the bureaucracy. Balcerowicz acknowledged these problems and indicated an Agency for Foreign Investments had been established to deal with them.

Regarding debt, the delegation raised two issues: debt conversion strategies (debt-equity swaps) and debt reduction in return for environmental cooperation (debt for nature.) Balcerowicz had no objection to such strategies but did not see them "as a total package." Poland would be willing to engage in debt-for-nature swaps, but this could not be sufficient to retire Poland's entire foreign debt. He also said that debt-for-nature swaps had proven inflationary in Latin America. The delegation reiterated its support for such an approach.

The delegation asked if other countries were helping Poland solve its debt problem. Balcerowicz said that FRG holds the largest debt—\$6 billion compared to the U.S. at \$3 billion—but reduction of the German debt was fraught with political questions. The FRG, he said, was also buying Poland's debt in the secondary market. Poland plans to raise the issue to the political level at the Paris Club meetings with other heads-of-government. The delegation said

it would report this aspect of the problem to the President after returning to Washington.

According to Professor Geremek, Chairman of the Citizens' Parliamentary Club in the Sejm, Poland still has a large debt with the Soviet Union (5 billion rubles). President Jaruzelski, he told the delegation, was in Moscow the day the delegation arrived in Warsaw (April 12) to raise two issues with Gorbachev: the debt and the Massacre at Katyn. Geremek said that Poles hoped that the Soviet Union will openly acknowledge that the Soviet Union was responsible for the massacre of Polish officers. Previously, the Soviets had blamed the Germans for the massacre.

The delegation asked Geremek which of the two issues was the more important. He said, "Katyn." Geremek said there can be no normalization of relations between Poland and the Soviet Union until Katyn is resolved. One implication to admission, he said, was economic: by acknowledging its actions, the Soviet Union may have to pay restitution. More than 14,000 Polish officers were murdered at Katyn, and 10,000 bodies are still missing. The Soviets may fear that Katyn will set-off a chain reaction, leading to demands for compensation and perhaps to the discovery of other similar murders. (NOTE: On April 13, Gorbachev admitted the Soviet Union was responsible for the massacre.)

The delegation detected in this and other conversations a somewhat different attitude about foreign investment than it found in Hungary. In the latter case, a fundamental decision appears to have been made—at least so far—to welcome it. In Poland, and also in Czechoslovakia, there appears to be a greater degree of ambivalence about its value (based on sensitivity to the problem of accurately pricing state-owned assets) which will likely manifest itself in more restrictive regulations and fewer incentives. In Poland in particular, part of this is related to concerns about German acquisitions that is rooted in historical conflict.

From the standpoint of the investor, however, the question will not be whether Poland, for example, is a good place to invest. It is whether it is a better place than the other opportunities available, including those in the West. Foreign capital cannot be forced in; it must be enticed in. That means, first and foremost, creating political stability so investors have confidence in the future. In economic terms it means allowing repatriation of profits and control of management and labor by the investor. These two elements have consistently been the obstacles most clearly identified by those seeking to undertake joint ventures in Eastern Europe.

Joint Ventures and Technical Assistance

The delegation raised with Balcerowicz the problems U.S. companies faced with joint ventures in Poland because of the lack of an accounting system. Balcerowicz said that Poland was attempting to develop a Western-style system but needed to train more people, especially accountants. He said Poland has discussed the need for this type of technical assistance with the IMF and discovered in the process that the IMF's methods are compatible with what Poland requires. There is, however, the need for more help in this area, and Solidarity cannot afford to wait any length of time.

The delegation asked Balcerowicz to be specific about financial and technical assistance needs. Balcerowicz said that the U.S. needs to speed up the flow of assistance that has already been authorized. Poland, in turn, needs to set-up financial assistance institutions and take initiatives to encourage U.S. investment. Poland, he said, seeks a balance in foreign investment, and it would not be correct to conclude that Poland is seeking only German investment.

Regarding initiatives with the United States, Balcerowicz said that Poland has proposed some foreign investment opportunities to the U.S. government. For example, a Polish banking delegation visited Washington to seek assistance for the banking sector, and the government has also raised the issue of U.S. government assistance in restructuring state enterprises before proceeding with privatization. Poland requested 20 people from the U.S. government for this initiative, but apparently that has not been acted upon as yet. Poland has also considered requesting assistance from AID to obtain concessional financing in housing. The Prime Minister raised this issue during his visit to Washington, Balcerowicz said, but details still need to be worked out.

The delegation asked Wojcik if U.S. firms could own 100% of a state-owned enterprise. Wojcik said that the bill on privatization was currently being considered in the Parliament, and foreign ownership was a controversial point. In this area, he predicted that there may be more limitations in some cases, such as large factories, than others. The Parliament may set certain levels of foreign ownership—20-40%—depending on the market or individual factor.

Labor

According to Labor Minister Kuron, the Polish situation is different from other Eastern European countries. Poland needs to work on its political, economic, and social stability. The first stage was to fight inflation. The Polish people have accepted this as the first condition for the success of the economic reform program. Poland stopped inflation, but at the cost of a recession. Economic stagnation, he said, had its own internal logic, and overcoming it would depend more on social mobilization than on foreign capital, important as that was.

Poland, Kuron continued, is on the right track. Polish society has accepted the hardships that go with reform. There is a "degree of stability" now. But, destabilization around Poland, e.g., the Baltics, can endanger Poland's own stability. The situation in these countries will get worse before it gets better. In Czechoslovakia, the use of subsidies will have an adverse effect on the economy. When the subsidies end, people will strike. Poland has told Czechoslovak President Vaclav Havel that the inflation ahead will be tremendous. The threat to Poland is not so much from Germany, but from the lack of understanding of the full implications of the collapse of communism. Problems associated with the collapse of the old political and economic system constitute the number one problem to stability and peace.

Kuron continued with a gloomy assessment of the total European situation: Germany will experience these problems first as it pro-

ceeds with unification. He predicted that the expense associated with unification will rip the German social safety net. Germany was ruined after World War I and the result was Hitler and another world war. After World War II, the West forgave most of West Germany's debts. However, Kuron sees what is happening today in Eastern Europe as more dangerous than the effects of two wars. Unfortunately, the West does seem to understand this. The threat to world peace today is not from war but from the economic collapse of Europe. East German unification will pull down the West German economy, which in turn will pull down the economy of Western Europe. The U.S. will feel it as well. Does the world need another war to teach it how to react to what is happening in Eastern Europe?

The delegation said that the Labor Minister's views were not unlike what it had heard from other Polish leaders during its visit to Warsaw. One Solidarity leader (Geremek) spoke about "hope" and what it meant for Poland. Hope, Kuron said, was fine, but he feared that external factors had the potential to undermine what Poland had built thus far. Poland, therefore, had to guard against factors that could harm its economic recovery program. In this regard, the Labor Ministry had concluded the following:

- There could be strikes in Poland in response to the economic reform program.
- Unemployment could grow and people could slip through the social safety net.
- Poland has no social safety net as yet.
- A solution to these problems lies in the expansion of the private sector, particularly of small businesses.
- Poland has many young people; Poland needs to create long-term institutions to help people find the opportunities needed to assist them. One such program is the student placement program. Student unemployment among graduates in 1989 was very high.
- Training is the centerpiece of the long-term institutions needed such as accounting, banking, clerical skills, and foreign languages, to name a few.
- There are two ways to acquire knowledge and experience. First, send the young people to the West for training and second, hire Western consultants to come to Poland, stay in Poland, learn in Poland, and live in Poland.
- Credit is essential to the success of the plan. Poland has established a "Bank for Social-Economic Initiatives" (BISA), a smaller, private bank that would loan money for promising projects. France is helping to establish the Bank and is providing experts for it. A few experts who remain in Poland are more important than a great number of delegations of experts just passing through.

Regarding privatization, the Labor Minister divided the subject into two types: Small and large. Small privatization, including shops and equipment, should proceed quickly and with little legislation required. Large privatizations are more complicated because they usually involve state-owned enterprises with thousands of people. The workers have been led to believe that the factories belong to them, which complicates the privatization process.

There is a corresponding need to raise the interest of the workers in privatization. The government could start by selling stock at value in the factories. There is also a problem with bankrupt factories. Workers employed by financially sound factories prospered; those unlucky enough to work for bankrupt ones did not. The unlucky ones were not to blame for working in old industrial enterprises. Therefore, the government was drafting a privatization plan that will include the following points:

- Privatize the healthiest enterprises first.
- Ensure that all shareholders have equal rights.
- Give the workers preferential treatment by selling up to 20 percent of the shares in the enterprise.
- Provide tax holidays for those that buy shares.

Although this was a particularly difficult meeting, it was also an important one because it demonstrated that the Poles are well aware of the political and social dangers inherent in their economic program and are making a major effort to head them off, both through use of the media and by the development of programs to ameliorate the adverse effects of economic reform. The Hungarians, in contrast, have not reached this point yet, although in fairness their new government has only just taken power. The new government would also no doubt respond that their more cautious pace of reform will not create the same social pressures, but that is unclear at this point.

Other Economic Problem Areas

Polish officials also offered their views on the following issues:

- The monetary squeeze.* Money was too difficult to obtain. There was also a slump in production. There were some individuals who were asking that more money be pumped into the economy now, but this would exacerbate inflation.
- Taxes.* Taxes and value-added taxes were also difficult issues. The tax bill was proving to be very difficult to pass.
- Relationship with the EC.* Poland wants access to the EC market, and has requested some provisional concessions such as lower duties and increases in suspended quotas. Poland also wants the elimination of restricted quantities associated with centrally-planned economies such as industrial goods (china-ware, shoes, etc.), the freedom of movements of its goods, access to labor markets in the EC, reapproachment on financial matters, and the movement of people.

Regarding the last point, there are Polish employees in the FRG at two levels: Official (under contract) and illegal (private contracts). Poland wants to regulate illegal contracts and is currently negotiating with the FRG an agreement for seasonal workers. Polish workers also enter into legal and illegal contracts in Austria. The main problem with these kinds of contracts is the impact money transfers have on Poland's balance of payments. Other countries with which Poland is negotiating worker's agreements include France, Holland, Italy, and other Scandinavian countries. Poland is requesting 200,000–300,000 visas from the FRG.

Strategic Trade

According to Wojcik, Poland's access to Western technology is very important. It touches all aspects of the country's infrastructure, and export control restrictions have clearly had an adverse impact on the acquisition of the technology needed to improve the infrastructure.

Regarding export controls and technology transfer issues, Wojcik said Poland has established two objectives. First, the government will work to convince the EC and COCOM that restrictions on exports to Poland should be lowered. Poland is looking forward to the June COCOM High Level Meeting in the hope it might achieve that purpose. Second, Poland wants to complete negotiations on some form of strategic trade agreements to safeguard Western technology from diversion.

The delegation also surmised that there could be substantial liberalization at the June HLM. In this regard, the delegation said the U.S. wants the emerging democracies of Eastern Europe to be aware that similar economic and political changes are needed in the Soviet Union before liberalization would be appropriate for it.

The delegation also expressed concern over Soviet efforts to acquire Western technology illegally and made clear that Poland's ability to stop illegal activities by the KGB and its front companies in Eastern Europe will determine where the line for liberalization will be drawn. The delegation emphasized that national laws discouraging illegal activities are necessary and inquired whether Poland had such laws.

Wojcik said that as of April 12 he did not know exactly what legal and other requirements the U.S. and COCOM need to facilitate technology transfer to Poland. Ongoing consultations, he said, will provide this answer. He also claimed that in some areas new laws may not be necessary since Poland already has an export control system for licensing imports and exports. The delegation asked whether the current export control laws cover the proliferation of private companies that is bound to occur with privatization. Because there has been no recognized private business sector, Polish law, Wojcik said, does not make any distinction between the activities of private and public sector companies. This suggests that current Polish export control laws may not be sufficiently precise to address diversion concerns of the U.S.

In other areas, Wojcik agreed, the Polish government would need tougher laws to meet Western security requirements. For example, a Polish Customs official acknowledged the delegation's point that a Customs-to-Customs agreement would be desirable, but one was not yet under consideration. Wojcik also acknowledged that security safeguard regimes such as the Customs agreement contained extraterritorial aspects, but that as a matter of general principle, Poland could accept this type of provision. Polish Customs, he said, may require more authority to do its job.

The delegation stressed that it was vital for Poland to put a technology safeguard regime in place to attract foreign investment. Poland will not attract the kind of investment it wants from the U.S. unless such investment can include appropriate levels of technology. Wojcik said the Ministry of Trade had some role in struc-

turing the joint venture law, which in turn had a link to exports, however, because the law on joint ventures stressed investment and privatization, the portfolio for foreign investment belonged to the Ministry of Finance.

Foreign Relations

According to Geremek, Poles have always believed that Poland was on the right side during World War II. The Western allies, he said, forget this point, and therefore forget Poland. Now that Poland has returned to democracy, Geremek said, Poland is "still expecting a response from the West." Up to now, he continued, there has been "no spectacular gestures from the West."

Solidarity leaders acknowledged that Poland wants to be on good terms with the Soviet Union. The delegation then addressed the question of what security architecture Poland envisages for Europe. Poland, Geremek said, cannot accept a divided Europe where Poland belongs to a Soviet sphere. Poland wants guarantees for its security as well as the security of the West. The question is how to construct the political architecture in which a united Germany is not a threat in Europe. Therefore, the first guarantee sought by Poland will be the integration of Poland into Europe.

The second guarantee, Geremek said, is the continuation of the U.S. presence in Europe. This, he said, is in the interest of Europe as well as the United States. The Helsinki process can be a partner to this political process by giving the U.S.—and Canada—roles in European problems and their solutions.

Geremek continued: the third guarantee involves the different axes that make up Europe's architecture. Previously, all solutions were East-West; now, axes consisting of regional and local integration are required. A North-South axis is also needed within this formula. Italy, Austria, Hungary, and Czechoslovakia might participate in other alliances, e.g., with Germany and the Soviet Union. Poland, Hungary, and Czechoslovakia could establish a "privileged" relationship. First, the three could begin with political consultations on education, the environment, etc. This could lead to the development of common attitudes and behavior, which in turn could facilitate membership in the EC. The three know they cannot be accepted economically in the EC in the short run, but they should be accepted politically. Poland has asked the Council of Europe to accept the three countries now. Poland cannot understand why this has not happened in view of the three countries' commitment to human rights and democracy.

The delegation asked Geremek if NATO should continue to keep its troops in West Germany. Geremek laughed and said that his first answer to the delegation on this question was deliberately evasive in order to avoid answering the question specifically, but on second thought, he said, the answer is "yes; the presence of U.S. troops is in the interests of Europe. This issue should also be discussed with the Soviet Union."

Geremek expressed the hope that the "Soviet army will leave Poland," but did not offer a timetable (as in Hungary and Czechoslovakia, which established June, 1991, as the date for the complete withdrawal of Soviet troops from the two countries). The United States, Geremek said, must understand that the Soviet Union has

its own security interests regarding Germany. In Poland, therefore, the Soviet army is strategically assuring. Currently, there are 50,000 Soviet troops in Poland. It is necessary to give them logistical support in East Germany. Then the Soviet army can start a step-by-step withdrawal from Germany and Poland as it has from Hungary and Czechoslovakia.

Geremek said that the question of NATO can be discussed at another time. NATO, he said, is an alliance of free countries voluntarily united. NATO could become a peace movement when Europe is secure. Today, Europe needs NATO and the United States. The presence of U.S. troops should be decided by those governments in Europe interested in this question.

Expanding on the idea of a North-South axis, the delegation noted that this idea runs contrary to the EC and Poland's attempt to become a part of EC-92. Geremek acknowledged this "pragmatic" point. Poland, he said, has no forum to meet in the EC now or in the near future. Poland should manage a political dialogue in a North-South axis, and along with the Scandinavian countries, organize a community of interests. Poland does not want to block its integration into a Europe which should also include other Central and Eastern European countries. Complete German integration into the European system is vital. In the next five years, Poland will look for other forms of economic cooperation, and will hope that the EC will accept Poland in the next 10 years. What is needed is a solution for the transition period.

The delegation asked what Poland proposes to create and what the economic commonalities are that would be different than those that exist today. Geremek said that one must begin with the environment. Sweden, he said, is the most industrialized country in the region, and the one with which Poland has the most common interests. Poland would like to develop and division of labor as the Benelux countries have. What are the possibilities of a North-South axis? The problem is that the Baltics are afraid. The Scandinavian countries fear that free Baltics cannot survive economically apart from the Soviet Union. Sakharov said, "Perestroika is what needs to succeed, not Gorbachev. Gorbachev can be the killer of perestroika."

Asked to predict the outcome of Lithuania's bid for independence, Geremek said that such a prediction required the following: first, decisions for independence by Estonia and Latvia; second, a decision by the Ukraine with its 55 million people. Poland, he said, can accept independence by the Baltics, but they would still remain tied economically to the Soviet Union while becoming democratic. Geremek's prediction: Lithuania's independence in 2-3 years, but this outcome is tied to the Ukrainian problem.

The Environment

On April 10, the delegation visited the Nowa Huta steel mill in Krakow. According to the plant engineer, Nowa Huta employs 28,000 workers, but this figure will be reduced to 26,000 by the end of 1990. Nowa Huta's current production is about 4 million tons of raw steel annually, which is down from an average of 4.4 million tons for 1989 and 6.5 million tons in 1980.

According to the plant engineer, Nowa Huta suffers from severe under-investment. More than 25 percent of the enterprise's income is spent on repairs. Many of its industrial processes waste energy and raw materials. A shortage of funds inhibits investment in pollution control equipment. The plant engineer estimated that Nowa Huta emits 23,000 tons of sulphur dioxide each year, which is 63 percent less than the total for 1980. A Solidarity adviser at the mill said management had only a vague idea of how much the steel mill emitted, since only a few of the over 700 smokestacks and other sources of emissions at Nowa Huta are monitored. The delegation agreed with this assessment.

Other local experts argue that the plant should give up trying to be an integrated enterprise and phase out raw materials processing, which is the most polluting aspect of production. The Solidarity adviser suggested that Nowa Huta is heading in this direction, noting, for example, that sales of coke to other enterprises have been virtually eliminated (all the coke will be utilized locally). About 2 million tons of coke will be produced this year, compared to 4.2 million tons 15 years ago. Plant management is pinning great hopes on purchasing a Western license for a continuous casting line, which will significantly cut energy and materials used.

Although it is Krakow's biggest polluter, the mill has taken some steps to cut back environmental damage. The mill has a completely closed water cycle and discharges virtually no pollutants into the Vistula River. Moreover, Nowa Huta seems to be honestly implementing a compromise pollution control agreement it reached last January with the Ministry of Environmental Protection, the city of Krakow, and local environmental activists. The compromise calls for a gradual phasing-out of some of the plant's most decapitalized and polluting departments. So far this year, two agglomeration lines and one coking battery have been closed. By 1992, gas and pollutant emissions could be cut by 25 percent.

Although the delegation examined environmental problems in detail only in the GDR and Poland, they are endemic in the region and will be a major obstacle to economic progress. The West had the relative luxury of being able to build and compete first and clean up second. Eastern Europe will not have that flexibility and thus will have to incur substantial costs for environmental protection at the very time their economies are least equipped to bear them. At the same time, since so much plant and equipment is outdated and obsolete, the necessity to replace it brings with it the opportunity to adopt cleaner technology.

Polish Views of U.S. Role

Polish officials, particularly Balcerowicz, said the U.S. had a role to play in Poland's restructuring of its economy. With regard to financial assistance, Poland requests that the U.S. speed up the flow of assistance already authorized. While the U.S. is not a major creditor, Geremek was more explicit: "cancel the debt!" Cancelling foreign debts, Geremek acknowledged, does not only involve Poland. But if the debt cannot be cancelled, he suggested that at least a major debt reduction program for Poland was essential. With regard to technical assistance, there is an overwhelming need for Western-trained accountants, auditors, and management con-

sultants for such basic infrastructural areas as the banking system. With regard to technological assistance, Polish officials requested that the U.S. and COCOM ease export control restrictions.

CZECHOSLOVAKIA

Status of Economic Reform Program

The Civic Forum spokesmen said that Czechoslovakia still has many laws to pass, including a privatization law, a foreign investment and joint ventures law, and foreign trade regulations, before the economic reform program gets off the ground.

There are, they said, many disputes and quarrels between two groups in the government with differing views on the pace and extent of economic reform. They said that on one side is the Minister of Finance, Vaclav Klaus, who proposes to stop the subsidies program despite the "unpleasant consequences" which are sure to arise from such a decision. Czechoslovakia has an "unrealistic" exchange rate that attracts people from Austria, the FRG, Poland, and Hungary to buy cheap goods. The government's first task is to stop this "buying on the cheap."

On the other side, they said, is the former First Deputy Premier Valtr Komerek, who favors a careful and conservative approach to economic (price) reform. The people, they opined, believe that now is the "time to put up or shut up," since national elections are scheduled in June and local ones in November.

The delegation asked what the people want the government to do. The Civic Forum members said that the Finance Minister's budget proposals with the cuts in subsidies went through without a problem. Everyone was surprised by the lack of negative reaction to the cut in subsidies. The people realize that things must change. In the small towns, people know that prices must go up; they are cooperating with the economic reform program. "Psychologically, people know some surgery is necessary," said one interlocutor. For now, the people of Czechoslovakia are being patient. The question is how long they will remain so. Going into the June elections, there is the expectation that things will improve, especially health conditions and the availability of food.

Privatization

According to the Civic Forum, the consensus in Czechoslovakia is that privatization must occur quickly. They said that the Civic Forum itself is unhappy with the pace and extent of privatization and has gone as far as to warn the government that it will become "an opposition" if the situation does not improve.

They continued: the state owns 96% of all enterprises, but 80% of agriculture is in private hands. Czechs are waiting for the privatization law to be passed in mid-April to see how privatization will be carried out. One of the most apparent problems with privatization is the lack of capital. The introduction of privatization will occur in three stages: small enterprises, larger, enterprises private and public through stock offerings, and the large state enterprises such as public utilities and railways.

Nationalism

The Civic Forum, they said, believes that the "most dangerous" issue in Czechoslovakia is the nationalities issue pitting Czechs against Slovaks. In the spring of 1990, the issue in dispute is the new name for Czechoslovakia, a highly charged symbolic issue. Many names have been suggested, but it appears that the new name will be "The Czech and Slovak Federative Republic." (NOTE: In mid-April, this name was officially adopted by the government.)

Relations with the Soviet Union

The delegation related the story of Professor Geremek's reaction to Katyn, and asked the Civic Forum interlocutors if there was a similar story regarding Czech-Soviet relations. The interlocutors said that Czechoslovakia relationship with the Soviet Union was not marred by a Katyn-type issue. For example, Czechoslovakia has no intention at this time to raise the issue of Ruthenia, Czech territory lost to the Soviet Union after World War II. Nonetheless, Czechoslovakia wants Soviet troops out of the country quickly, and both sides have agreed on the removal of all Soviet troops by June, 1991. While in Czechoslovakia, they said, Soviet troops "did not behave well." The Soviets "stole uranium" from Czechoslovakia, or which Czechoslovakia has asked Moscow for payment.

Czechoslovakia's Pan-European Security Plan

Foreign Minister Dienstbier spent the better part of one hour briefing the delegation, which had also been joined by a House delegation for the meeting, on Czechoslovakia's proposal to establish a new security commission whose structure would extend "from San Francisco to Vladivostok." The plan, he said, was to replace both NATO and the Warsaw Pact, two security organizations that were the products of the Cold War. The foreign minister said that to overcome the divisions caused by the war it was necessary to overcome the structures of the war. He said that when U.S. Secretary of State James Baker asked him what Czechoslovakia had against NATO, the Foreign Minister replied: "nothing, but Czechoslovakia cannot join NATO."

Dienstbier continued: Foreign countries also had to understand that any Czech move to join NATO would be complicated by its impact on the prestige of the Soviet Union. Nonetheless, the ideal solution was for Czechoslovakia and Hungary gradually to join NATO. The alternative was to create one strong structure that included NATO plus other countries. France and the West Germany have indicated they could agree to such an arrangement. Cooperation is already developing through the Council of Europe, to which Czechoslovakia, Hungary, and Poland would become members. This, then, would form the first truly Pan-European security system.

The foreign minister said the new security system would be based on respect for human rights. If the present trends continue in Eastern Europe, there will only be democratic regimes in Europe. Thus, against what countries would NATO be directed? Short-range missiles, for example, can only be targeted against Poland, Hungary, and Czechoslovakia, which is an "absurd

thought." The Council of Europe, with members of the emerging democracies of Eastern Europe, could influence the foreign policy of the Soviet Union as well.

In this regard, the Warsaw Pact, he said, has lost its original meaning and mission. Its purpose has never been to conquer the United States or Western Europe. Its purpose was to maintain stability in Europe, but this purpose no longer exists. One advantage of membership in the Warsaw Pact was that Czechoslovakia was able to influence arms control issues.

Troop reduction, he said, is a task for the Pan-European Council to address. Currently, there is a proposal to reduce troops on both sides to 195,000. Soviet troops will be withdrawn from both Hungary and Czechoslovakia. German reunification poses a question regarding the size of the Soviet army in Germany.

Regarding German reunification, there is a question as to which security organization the new Germany will belong to, NATO or the Warsaw Pact. Czechoslovakia, because it is a small country, can help to resolve this problem because it is not a superpower and does not stand to gain from its resolution. These comments were a further reflection of the Czech interest in playing a larger role on the world stage, although there has not historically been a shortage of smaller states willing to do the same thing. The delegation did not comment on this matter, having focused its primary attention on economic and political reform within each of the countries visited.

Strategic Trade

The Foreign Minister said that access to Western technology is one of the highest priority areas for Czechoslovakia. Czechoslovakia's technology dates back to the 1950s. There is a need for new technology to improve the educational system, business, and other areas. Czechoslovakia hopes to negotiate a technology transfer agreement with the United States soon. Then, follow this agreement with similar ones with the G-24 and the EC. Currently, Czechoslovakia is negotiating a memorandum of understanding with the G-24. Issues raised by the United States, including Customs agreements and strategic trade agreements with security safeguards, are currently under discussion at the working levels of the Czech government. The Czech government recognizes that Western technology acquired by Czechoslovakia must not be permitted to go to the Soviet Union.

Czechoslovakia, he said, is still dependent on the Soviet Union for trade. The objective now is to diversify relations so as not to be dependent on one country. Czechoslovakia wants relations with the U.S. and Japan.

Discussions with the PLO

The delegations noted that Czechoslovakia was hosting a visit from PLO Chairman Yassar Arafat, and asked the foreign minister how Czechoslovakia viewed its role in the Middle East. The foreign minister characterized his discussions with Arafat as "very successful." Arafat, he said, was for democracy and peace for Jews in Palestine. There was a role for Czechoslovakia in the Middle East, but

it has been out of the Middle East for 20 years, and needs to start thinking about the region and its problems.

CONCLUSIONS

The delegation's visit to Eastern Europe had three objectives:

1. Take a first-hand look at the dramatic changes that have occurred in Eastern Europe since the spring of 1989.
2. Gauge the extent of the problems and prospects for the success of political democracy and economic pluralism in the region.
3. Assess the best way to promote permanent economic change through direct, Western private investment and access to Western high technology, and to evaluate U.S. investment and trade opportunities in the area.

First-Hand Look

Despite the whirlwind nature of the visit to Eastern Europe (four countries in five working days), the delegation was satisfied that it had met with a sufficient cross-section of government officials and political leaders in each of the four countries to draw meaningful conclusions regarding the nature and extent of the political and economic revolutions occurring in Eastern Europe today.

The overall impression gained from the visit was of countries in the midst of profound and permanent political and economic change. Insights gained from substantive discussions in the delegation's many meetings were reinforced by less formal impressions gained in the cities visited by the delegation. The commentaries of individual speakers on their experiences under the old communist system and their hopes for a free future were deeply moving and not easily captured in the words of a report.

An example of such a moving personal testament was the tour of the Bitterfeld chemical works provided by Hans Zimmerman, the environmental spokesman for the town. He exuded a genuine fervor for the prospects of democracy succeeding in East Germany, and saw the democratic process holding the solution to the environmental disaster of Bitterfeld that the previous regime could not and would not provide.

These impressions were reinforced in small East German cities, where posters with the faces of communists running for office were covered with graffiti. In Krakow, Poland, where the Solidarity representative at the Nowa Huta steel plant rode back to Krakow with the delegation and spoke of his profound belief in the democratic process. In Auschwitz, where the guide broke into tears as she led the delegation through the concentration camps. In Prague, where small entrepreneurs lined the Charles Bridge representing the seeds of the free market system in this Eastern European city after a 40-year hiatus, and where Easter Mass was celebrated at the cathedral in Prague before a capacity crowd.

In Budapest, the city was plastered by political posters that rivaled those in the United States for creativity and visual impact. Three posters, given to each member of the delegation by the Prime Minister-to-be Antall, stand out: one of a garbage can full of statutes, books, and paraphernalia associated with communism and

labeled "Spring Cleaning;" a second one of a young boy looking toward the future with a caption taken from the Lord's Prayer that reads, "Thy Kingdom Come;" and the third, the back of the fat Soviet soldier with the caption: "It's over, Comrades."

In Poland, Hungary, and Czechoslovakia, the fledgling political parties included in their political platforms such Western values and principles as freedoms of speech, thought, religion, free elections, and the free enterprise system. The delegation returned convinced of the irreversibility of political and economic change in the region, as one country after another has shed its communist system in favor of a Western democratic model.

Problems and Prospects

1990 is the year that will give form and substance to the political and economic revolutions in Eastern Europe. Basic political and economic freedoms have by and large been won at the national levels; central governments are slowly taking shape. The hard, detailed work of serious economic reform, and the hardships that inevitably go with it come next.

It is difficult to predict how that process will evolve in each country. What does seem clear is that there will be significant differences. None of the countries visited had identical priorities or agendas, and the delegation did not expect to find them in any event.

Politically, the removal of Communists from key political and economic positions in the national government is offset by their continued presence in the bureaucracies. That does not augur well for the efficient, good faith implementation of the economic reform programs that are beginning to appear. The unrealistic views regarding unemployment expressed by former nomenclatura in the Nowa Huta steel plant is but one example of the internal footdragging one may expect during the transitional phase of the revolutions in Eastern Europe. Poland is the farthest down the road, and in that sense provides some important lessons for the other countries. At the same time, differences in the social fabric and sense of political unity in each of the countries makes any lesson of limited applicability.

The GDR notwithstanding, Poland, Hungary, and Czechoslovakia are at different stages in their revolutions. Because of the diversity and numbers of political parties, coalitions, mixed economies, and nascent foreign policies, each country will likely shape its new administration and policies according to its pre-Communist traditions and each country's current social constituencies and political trends. In Hungary and Czechoslovakia, the delegation was left with impression that the dissidents that now from the government were not quite sure how to balance the new with the old. In Poland, where some of those decisions have been made, there is growing evidence of internal disagreement within Solidarity over the wisdom of the path that has been chosen.

The disintegration of the single-party state is having a profound effect on political unity in the newly emerging countries of Eastern Europe. The fall of Communism has given rise to a plethora of political interest groups competing in a new and largely unknown political market place. the dozens of new political parties competing in this new market place are all seeking public support for their

new but little understood policies. In Poland, Hungary, and Czechoslovakia, there was agreement that the people did not understand what a "free market economy" meant, but there was also little evidence that the new political leadership itself fully understood the implications of the concept, although it was an integral part of most of their campaigns.

The difficulties of coming to grips with the fall of the one-party state, the creation of a multi-party system, and the complex economic decisions that have to be made may also prove to be extraordinarily difficult challenges for new governments whose primary past experience has been as political dissidents persecuted by previous regimes. It is a cliché that those who make a revolution are not always the best ones to implement it, but several of the countries the delegation visited may have to wrestle with this problem as well.

The re-emergence of nationalism in Eastern Europe is potentially the single most destructive force to the political revolution in the newly emerging democracies. The delegation was treated to a first-hand demonstration of the religious differences that exist in Czechoslovakia when two of the Civic Forum interlocutors nearly broke into a heated argument during the meeting with the delegation. The issue arose when one of them suggested that the Catholic Church in Czechoslovakia was a tool for the "Germanization" of the Slovak Republic, to which the other replied, "absolute nonsense!"

In Hungary and Czechoslovakia, the delegation learned of long-suppressed national aspirations for cultural, linguistic, and religious equality, and regional autonomy. Ethnic diversity—and the political animosities fostered by that diversity—was responsible for the name change in Czechoslovakia. In Romania, a country not visited by the delegation, violence erupted in Transylvania between Rumanians and Hungarians. In Yugoslavia, ethnic problems threaten to split the country into six different parts. Indeed, the Soviet Union itself is experiencing first-hand the effects of ethnic and cultural diversity and the threat of its republics seeking national independence.

With respect to economic reform, Poland, Hungary, and Czechoslovakia are similar in that they suffer from industrial obsolescence, stagnant production, substantial foreign indebtedness (Czechoslovakia expected), and distorted and inefficient centrally-planned economies. Ironically, Poland and Hungary—along with Yugoslavia—were the first Eastern European countries to attempt the most market-oriented reforms. The central problem facing each country now is how to transform these failed mixed economies into real free market systems—and still maintain political, economic, and social stability.

In Poland, Hungary, and Czechoslovakia, the delegation was satisfied that the political leadership (although not necessarily the bureaucrats) understood the extent of reforms required to address such issues as eliminating subsidies to enterprises and consumers, preparing for the inevitable increase in unemployment arising from such policies, and girding themselves against widespread bankruptcies. These leaders also appeared to understand that the reforms would also lower living standards and wages initially. Cer-

tainly, the meeting with the Labor Minister in Warsaw clearly showed that the leadership in Poland understood the implications of its decision to implement a radical reform program.

What was not so clear to the delegation was the pace of reform. Poland, Hungary, and Czechoslovakia were at different stages in the implementation of their economic reforms. Poland was the only country that had opted for a radical and swift break with state control. Hungary and Czechoslovakia had opted for a gradualist approach; the economic legal structures were also in draft stages.

The environment is one area sure to feel the impact of the different economic strategies. Environmental blight is endemic to Eastern Europe, but the stark reality is that the countries of the region hit the hardest by environmental blight are those in the process of transforming their economies and are in no position to invest heavily in environmental controls. According to the Congressional Research Service, over half of western Czechoslovakia's forests and a third of the forests in East Germany and Hungary have been devastated by acid rain. Almost half of Poland's 800 major towns have no sewage treatment plants and dump sewage directly into rivers and lakes. Eighty percent of East Germany's rivers are contaminated. Clearly, Bitterfeld and Nowa Huta were but the most visible tip of an environmentally-blighted iceberg in Eastern Europe.

Western aid for environmental cleanup is simply insufficient. For example, according to media reports, the West German government has pledged about \$600 million in environmental aid to East Germany, a sum which includes money for Bitterfeld. But some estimates indicate that it will cost up to \$200 billion during the next 20 years to clean up East Germany's environmental problems.

The 1989 Support for Eastern European Democracy Act (SEED I) contained \$10 million in environmental assistance to Poland and Hungary. The \$10 million was earmarked for retrofitting coal-fired plants in Poland. Nowa Huta's share was used to retrofit only one of a dozen major furnaces at the plant and not necessarily the worst one in the region.

The revolutions in Eastern Europe have also had a profound effect on questions of Europe's security. The Warsaw Pact has all but vanished, but NATO remains, although its future role is under debate. The consensus in Poland, Hungary, and Czechoslovakia is that the U.S. still has a *military* role to play in the security of Europe.

This consensus has to be understood in the context of the larger question of German reunification and all it will entail. In Poland, where the question of German reunification is being closely watched, officials have been the least enthusiastic in calling for the removal of Soviet troops. In Hungary and Czechoslovakia, where the question of German reunification is not as sensitive, Hungarian and Czech officials have already reached agreement with the Soviet Union for the removal of Soviet troops by mid-1991.

Poland, Hungary, and Czechoslovakia are all grappling to find a formula for their participation as equals in a "Pan European Security System." None presented a convincing argument for such a system. But all agreed that in the interim, NATO's presence in European political and economic integration was a necessary condi-

tion. All agreed that the U.S. had a military role to play in that integration.

The delegation left each country with a better understanding of the magnitude of the political and economic problems each country faces in 1990. The magnitude of the diverse problems each country faces underscores the need for strong and stable leadership in each country. The alternative—instability—has consequences that are not in the interests of the United States or the countries themselves: the emergence of political systems antithetical to democracy.

Western Private Investment and Technology

There is no question that Western financing and technological assistance are needed and desired in Eastern Europe. The only question is the form they should take, given the special needs of each country, and whether they will materialize. The six most frequently mentioned Western actions to assist economic reconstruction in Eastern Europe were (in no particular order of priority):

- integration into a common European market.
- assistance to help finance a social safety net, a message clearly delivered by the Polish Labor Minister.
- debt reduction or conversion.
- credits and direct investment.
- technical assistance.
- relaxation of export controls.

While some of these measures will require action and assistance from Western governments, which is certain to be provided in many areas, the officials the delegation met with recognized the central and critical role in the areas of capital flows that must be played by Western private investment. They also seemed to recognize that encouraging Western private capital to flow into their countries will require building a new legal, financial and policy framework that can provide assurances necessary to encourage foreign investors to risk their capital on Eastern Europe.

Major Problem Areas

The new governments in Eastern Europe face a number of major problems in their efforts to convince the West that private financial and technological assistance is welcome and could be pursued with confidence.

First, with the exception of East Germany after monetary union with the West on July 2, neither Poland, Hungary, or Czechoslovakia have freely and fully convertible currencies. Western investors therefore face fundamental questions about whether they will be able to repatriate profits and about realistic valuation of the costs of transactions between the West and the host country.

Second, despite first steps in each country away from central planning and pricing, it is very difficult to achieve any meaningful valuation of land, assets, or inputs to production in Eastern Europe. The value of land, which has typically been state-owned and not transferrable, is unknown and will remain so until a free market in real estate develops. More generally, there is no concept of cost accounting in the Western sense. Changes in law, regula-

tion, and practice to permit market development, along with Western technical assistance, will be needed to rectify these problems.

Third, none of the countries yet have necessary and sufficient legal frameworks in place that would set out clear rules for foreign ownership and control of domestic companies or would provide assurance of predictable legal treatment and protection of the rights of foreign investors.

Fourth, many prospective investments in the region will certainly involve Western high technology and, while it is clear that the four countries are anxious for access to such technology, this is an area that is currently fraught with policy problems. Restrictive Western export controls must be maintained because none of the four countries currently has in place the necessary legal framework either to protect legally acquired Western technology or to punish violators of host country export control laws. This is a particular problem given the countries' continuing trade links with the Soviet Union and past record as conduits for illegal diversions of Western technology.

Not surprisingly, given all these uncertainties, Western investors, including those from the United States, have adopted a wait-and-see attitude toward direct investment and other financial relations with Eastern Europe. Aside from these concerns specific to the decision to invest in a particular country, there are two broader political concerns affecting Western investor confidence as well.

On the one hand, it is clear from the geography of the region that the largest source of financing and direct investment for these countries, certainly in the early going, will come from West Germany. Many Western investors may view the German investment position and potential to claim the best opportunities, especially in East Germany, as insurmountable. If these countries are to encourage the broadest possible access to Western capital and avoid overreliance on a single source of capital, like West Germany, about which they have expressed concern, the governments will have to go out of their way to assure Westerners that all assistance is welcomed.

On the other, Eastern European countries must reassure Western investors that their present excessive reliance on planned trade in inconvertible currencies with CEMA and the Soviet Union will be reduced in the next few years. While more Western-oriented trading partners are clearly needed and desired, however, it is clear that there is no quick fix to Eastern Europe's dependency on the Soviet market.

Eastern European Confidence Building Measures

The GDR, Poland, Hungary, and Czechoslovakia are responding to these challenges by drawing up legal blueprints for the reconstruction of their economies as well as adopting substantive confidence building measures to facilitate Western private investment and technology transfer.

Regarding confidence building measures to facilitate Western private investment, the four countries have addressed the following legal concerns:

—Hungary has developed new legislation that allows foreign investors, whether individuals or organizations, to buy equity in

formerly state-owned private enterprises. Foreigners may also purchase real estate provided the property in question is not considered a national treasure. Approval is automatic for investments totaling 50% of a Hungarian enterprise, but 100% ownership is possible through government approval. Foreign investors can repatriate profits in hard currency.

- Poland is circulating draft proposals to promote greater economic competition and free enterprise. However, new legal protections for private property are proving nettlesome. Unlike Hungary, foreigners cannot directly own real estate. Foreigners, however, may own the majority of capital in a joint venture and establish wholly-owned Polish ventures. Repatriation of profits is currently restricted by temporary laws regarding hard currency convertibility. The government appears unreceptive to 100% foreign ownership of joint ventures even on an interim basis.
- Czechoslovakia has draft laws to remove barriers to private business while improving private property rights. Foreigners will be allowed to own up to 100% of joint ventures. Unlike Hungary and like Poland, Czechoslovakia intends to limit hard-currency repatriation to a share of hard-currency earnings. Czech currency is not fully convertible at present.
- The GDR intends to stick to a social market economy in the short term thus raising questions regarding the ownership of private property. Foreigners cannot now own real estate. A new joint venture law allows foreigners to own 49% and this figure may be increased up to 51% for small enterprises. There are no legislative limits on repatriation of profits, an issue that may well become a moot point with monetary union of the two Germanies.

With regard to security concerns, Poland, Hungary, and Czechoslovakia have already tried to address U.S. and Western security concerns by adopting the following important confidence building measures:

1. Hungary and Czechoslovakia have negotiated the withdrawal of Soviet troops by June 30, 1991. Poland has indicated that it will do the same once the issue of German reunification is resolved.
2. Poland, Hungary, and Czechoslovakia have announced their intention to lower their defense budgets, reduce troop strengths, and phase out their participation in the Council for Mutual Economic Assistance (Comecon or CEMA).
3. Some countries in the region made clear to the delegation their intention to remove Soviet intelligence agents within their borders.
4. Poland, Hungary, and Czechoslovakia have made clear their willingness to negotiate technology security arrangements on our terms and to enact legislation to make their obligations statutory and to provide penalties for violators of U.S. laws as well as their own.

Recommendations Regarding the Relaxation of Export Controls

The United States has an unprecedented opportunity to assist in the economic and political transformation of Eastern Europe by using Western technology and private direct investment to promote free market mechanisms. This will be a key to the success of political democracy in Eastern Europe. One of the most direct ways to assist the process is through relaxation of export controls, which was a principal focus of this trip.

Shortly after the delegation's return from Eastern Europe, Senators Heinz, Garn, Bond, Chafee, and Sanford wrote to the President urging him to take certain measures to relax export controls toward the GDR, Poland, Hungary, and Czechoslovakia and other countries that implement confidence building measures discussed above (for text of the letter see the *Congressional Record*, June 8, 1990, pp. S7634-7636). The Senators made the following recommendations:

1. Shift Poland, Hungary, Czechoslovakia, and the GDR (if applicable), to Country Group T or V (Free World Nations) in the Commerce Department's regulations.
2. Following the negotiation of effective technology safeguards, decontrol to the China Greenline for Poland, Hungary, Czechoslovakia, and the GDR.
3. Extend favorable consideration treatment, i.e., presumption of approval by COCOM, for export to Poland, Hungary, Czechoslovakia, and the GDR of items above the China Greenline.
4. Direct the National Security Council to fulfill the U.S. commitment made in January, 1988, to develop a new "Core List"—a significantly streamlined U.S. control list that will serve as the model for negotiating a similar streamlining of the COCOM control list.

EPILOGUE

On June 6-7, 1990, the 17-nation Coordinating Committee for Multilateral Export Controls met in Paris to undertake the first significant review and reduction of the COCOM control list since the first such exercise in 1954. COCOM agreed to reduce significantly controls to the emerging democracies of Central and Eastern Europe. The agreement, to be sure, does not *ipso facto* ensure the success of the economic reform programs the GDR, Poland, Hungary, and Czechoslovakia have embarked on, but the agreement ensures that the lack of access to Western technology will not be an obstacle to that success.

The High Level Meeting reaffirmed the belief of the five Senators that COCOM remains an essential element of Western security. As the Senators recommended to the President, COCOM agreed to a comprehensive reassessment of controls to respond to the recent historic changes in Eastern Europe.

Member governments agreed to a substantial streamlining of the control list. For much of the list, the special notes in many entries of the Industrial (dual-use) List that afforded preferential treatment to the People's Republic of China now represent levels of

total decontrol. With regard to three priority sectors—computers, telecommunications, and machine tools—the following are the highlights of the agreement:

- in addition to decontrolling virtually all personal computers and associated peripherals, as well as some small mainframes, access to much higher levels of computer equipment and technology is made possible for Eastern Europe through liberalization in national discretion and favorable consideration treatment.
- beyond decontrolling satellite ground stations for civil television, weather and earth resources communication, and some digital switches (larger ones can be exported under national discretion treatment), special procedures are provided for Poland, Hungary, and Czechoslovakia to obtain fiber optic and microwave transmission equipment, more advanced digital switching, common channel signalling, and other equipment and technologies to incorporate the latest switching, common channel signalling, and other equipment and technologies to incorporate the latest switching features for long distance and local telephone service. This treatment is more generous than that previously provided to the PRC.
- Eastern Europe will benefit from decontrolling new generation 32-bit numerical controllers for machine tools, and industry standard machine tools with positioning accuracies to the ± 2 to 4 micron range.

COCOM also agreed to a set of interim measures for technology transfer to the GDR. These provide for liberal technology transfer to the GDR, subject to new export control laws and Customs enforcement procedures, during the transition from a single German market to a single German state.

In addition, COCOM members agreed to completely overhaul the existing Industrial List (which forms the basis for the U.S. Commodity Control List), and negotiate a new "Core List" by the end of 1990. When the streamlining exercise is completed at the end of the year, the China Green Line will cease to exist as such.

With regard to Poland, Hungary, and Czechoslovakia, COCOM also agreed to a very wide-ranging special procedure for formerly proscribed countries that adopt appropriate safeguard regimes to protect COCOM-controlled technologies. When fully implemented, exports of all but a few dual-use items currently controlled at the General Exceptions level (item requires unanimous approval by COCOM for its export) will be considered under the Favorable Consideration procedure (presumption of approval) in COCOM. This is one of the recommendations the delegation made to the President. In sum, this key provision will allow the four Eastern European countries access to Western technology well above the China Greenline.

The COCOM agreement will permit the acquisition of technologies by the emerging democracies of Eastern Europe and enhance the ability of U.S. firms to compete successfully in seeking markets for their products through foreign investment.

Most importantly, the COCOM agreement endorses the delegation's recommendation calling for a policy of differentiation that treats the emerging democracies differently than the Soviet Union.

The remarkable changes in Eastern Europe have been made possible in no small measure by Soviet President Gorbachev's policies, but these policies have not been matched by the same kind of political and economic progress in the Soviet Union itself.

The Soviet Union will benefit from the agreement; it will have access to some technologies that have been decontrolled. But it will not have the access enjoyed by the new democracies and there will remain sensitive technologies on the new control list. For example, supercomputers, lasers, advanced telecommunications, advanced materials marine technology, and propulsion systems, will not and should not be made available to the Soviet Union.

